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The *Dispute Settlement Reports* of the World Trade Organization (the "WTO") include panel and Appellate Body reports, as well as arbitration awards, in disputes concerning the rights and obligations of WTO Members under the provisions of the *Marrakesh Agreement Establishing the World Trade Organization*. The *Dispute Settlement Reports* are available in English, French and Spanish. Starting with 1999, the first volume of each year contains a cumulative index of published disputes.

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UNITED STATES - IMPOSITION OF COUNTERVAILING DUTIES ON CERTAIN HOT-ROLLED LEAD AND BISMUTH CARBON STEEL PRODUCTS ORIGINATING IN THE UNITED KINGDOM

Report of the Panel
WT/DS138/R/Corr. 2

Adopted by the Dispute Settlement Body
on 7 June 2000
As Upheld by the Appellate Body Report

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I. INTRODUCTION

1.1 On 12 June 1998, the European Communities requested consultations with the United States pursuant to Article 4 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU), Article XXII:1 of the General Agreement on Tariffs and Trade 1994 (GATT 1994) and Article 30 of the Agreement on Subsidies and Countervailing Measures (SCM Agreement) with respect to the imposition of countervailing duties by the United States on certain hot-rolled lead and bismuth carbon steel products (leaded bars) originating in the United Kingdom in the context of three successive annual reviews (WTO document WT/DS138/1). The European Communities and the United States held consultations on 29 July 1998, but failed to reach a mutually satisfactory solution.

1.2 On 14 January 1999, pursuant to Articles 4 and 6 of the DSU, Article XXIII of the GATT 1994 and Article 30 of the SCM Agreement, the European Communities requested the establishment of a panel with respect to the imposition of countervailing duties by the United States on certain hot-rolled lead and bismuth carbon steel products originating in the United Kingdom in the context of three successive annual reviews (WTO documents WT/DS138/3 and WT/DS138/3/Corr.1).

1.3 At its meeting on 17 February 1999, the Dispute Settlement Body (DSB) established a panel pursuant to the above request. At that meeting, the parties to

the dispute agreed that the Panel should have standard terms of reference. The terms of reference were:

> "To examine, in light of the relevant provisions of the covered agreements cited by the European Communities in documents WT/DS138/3 and WT/DS138/3/Corr.1, the matter referred to the DSB by the European Communities in that document and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements".

1.4 On 16 March 1999, the Panel was constituted as follows:

Chairman: Mr. Ole Lundby

Members: Mr. Paul O'Connor

Mr. Arie Reich

1.5 Brazil and Mexico reserved their rights as third parties to the dispute.

1.6 The Panel met with the parties on 15-16 June 1999 and 14-15 July 1999. It met with the third parties on 16 June 1999.

1.7 The Panel submitted its interim report to the parties on 6 October 1999. On 20 October 1999, both parties submitted written requests for the Panel to review precise aspects of the interim report. On 8 November 1999, each party filed comments on the written request submitted by the other party. Neither party requested a further meeting with the Panel. The Panel submitted its final report to the parties on 22 November 1999.

II. FACTUAL ASPECTS

2.1 This dispute concerns the imposition of countervailing duties by the United States on certain hot rolled lead and bismuth carbon steel products originating in the United Kingdom in the context of three successive annual reviews.

2.2 On 8 May 1992, a countervailing duty investigation was initiated by the United States against imports of hot rolled lead and bismuth carbon steel from, *inter-alia*, the United Kingdom. The period of investigation was calendar year 1991. On 27 January 1993, the United States Department of Commerce (USDOC) issued a final determination establishing a subsidy rate of 12.69 per cent on imports from United Engineering Steels Limited (UES).[1] On 22 March 1993, following an affirmative injury determination by the United States International Trade Commission (USITC), the USDOC published a countervailing duty order at the above rate on imports from UES.

2.3 During the period of investigation, UES was a joint-venture equally owned by British Steel Public Limited Company (British Steel plc) and Guest, Keen and Nettlefolds (GKN), both of which were privately-owned companies.

[1] Final Affirmative Countervailing Duty Determination: *Certain Hot Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom*. Federal Register, 27 January 1993, Vol. 58, No. 16, pp. 6237-6246.

The alleged subsidies countervailed were not provided to either co-owner of UES but to state-owned British Steel Corporation (BSC). BSC established UES in 1986 in association with GKN. British Steel plc was related to BSC in the sense that the former assumed the property, rights and liabilities of the latter in September 1988. The British government privatized British Steel plc in December 1988 through a sale of shares. Both parties agree that the privatization of British Steel plc was "at arm's length, for fair market value and consistent with commercial considerations".

2.4 On 21 March 1995, UES became a wholly-owned affiliate of British Steel plc as this company bought out GNK's interests. UES was subsequently renamed British Steel Engineering Steels (BSES).

2.5 The alleged subsidies countervailed relate principally to equity infusions granted by the British Government to BSC during fiscal years 1977/78 - 1985/86. The USDOC classified such alleged subsidies as non-recurrent and thus spread them out over 18 years, deemed to be the useful life of productive assets in the steel industry. The USDOC found that the alleged subsidies in question "passed through" from BSC to UES first, and then more recently to BSES.

2.6 Following the original imposition of CVDs in March 1993, the DOC has undertaken six annual reviews to set the duty rate on imports of the subject product. The first review is not being challenged as it was initiated on 15 April 1994, prior to the entry into force of the SCM Agreement. The fifth review, initiated on 24 April 1998, is not being challenged either as it was completed (11 August 1999) after the request for establishment of the Panel (WTO documents WT/DS138/3 and WT/DS138/3/Corr.1). Similarly, the sixth review, initiated on 30 April 1999, is not subject to challenge given that it was opened after the request for establishment of the Panel. Therefore, the subject of this Panel are the outcomes of the second, third and fourth reviews, initiated in 1995, 1996 and 1997, respectively. UES and BSES were the only exporters involved in these reviews.[2]

2.7 The 1995 review, covering imports during calendar year 1994, was initiated on 14 April 1995 and was completed on 14 November 1996.[3] In this review, the USDOC determined a subsidy rate of 1.69 per cent on imports from UES.

2.8 The 1996 review, covering imports during calendar year 1995, was initiated on 25 April 1996 and completed on 14 October 1997.[4] In this review, the USDOC established two separate subsidy rates on account of the fact that UES transformed itself into BSES during the period of review. In particular, the USDOC established a subsidy rate of 2.40 per cent, applicable to imports from UES made during the period 1 January 1995 through 20 March 1995, and an-

[2] Allied Steel and Wire Limited (ASW Limited) was involved in the original 1992 investigation as well as in the 1994 review. However, this company has not participated in any subsequent reviews.

[3] *Certain Hot-Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom*; Final Results of Countervailing Duty Administrative Review. Federal Register, 14 November 1996, Vol. 61, No. 221, pp. 58377-58383.

[4] Ibid., 14 October 1997, Vol. 62, No. 198, p. 53306.

other subsidy rate of 7.35 per cent, corresponding to imports from BSES during the period 21 March 1995 through 31 December 1995.

2.9 The 1997 review, covering imports during calendar year 1996, was initiated on 29 April 1997 and was completed on 15 April 1998.[5] In this review, the USDOC determined a subsidy rate of 5.28 per cent on imports from BSES.

III. ARGUMENTS OF THE PARTIES

3.1 The arguments of the parties are set out in their submissions to the Panel (see Attachments 1.1 through 1.7 for the European Communities and Attachments 2.1 through 2.8 for the United States).

IV. ARGUMENTS OF THE THIRD PARTIES

A. Brazil

Brazil made the following written arguments as third party:

4.1 In the past decade, the US Government has issued a series of countervailing duty decisions regarding privatization. These decisions have affected, and continue to affect, a wide variety of products and countries, including Brazil. In the view of the Government of Brazil, the US Government's analysis of privatization has led consistently to countervailing measures (hereinafter CVDs) contrary to the US international obligations under the GATT 1994, and the Agreement on Subsidies and Countervailing Measures ("SCM Agreement").

4.2 The US actions and findings are inconsistent with its obligations under the SCM Agreement in two significant respects. First, the US analysis fails to recognize a duty intrinsic to Article 1 of the SCM Agreement to analyse and detect the conferral of benefits to a company during the period of investigation. This duty includes an obligation to consider all information relating to developments, such as changes in ownership, subsequent to an initial financial contribution.

4.3 The US argues that the SCM Agreement creates no duty to consider the impact of subsequent events on the flow of benefits after an initial subsidy event is detected. The US argues it can presume, irrebutably, that the benefits of an initial subsidy event continue to flow to the new owners of an asset or company even after an arm's-length sale or privatization. This irrebuttable presumption, in and of itself, is inconsistent with the Article 1 of the SCM Agreement.

4.4 Second, given this obligation to find a benefit conferred to the company subject to investigation during the period of investigation, it is relevant how an arm's length sale affects and eliminates the conferral of benefits from a pre-sale subsidy to the purchaser. An analysis of benefit, consistent with the SCM Agreement, leads to the conclusion that a purchaser of assets (or a company) in an arm's length transaction does not receive any benefit from pre-sale infusions.

[5] Ibid., 15 April 1998, Vol. 63, No. 72, pp. 18367-18375.

4.5 Brazil believes it important for the panel to recognize that the US Government practice impacts its CVD decisions with respect to privatizations and changes in ownership in a variety of countries, including Brazil. With respect to all forms of arm's length privatizations, the basic flaws in analysis lead to the same basic violations of SCM Agreement principles.

4.6 Brazil provides a general framework for analysing pre-privatization subsidies. This framework will assist the panel in reaching a determination that addresses the flaws in the US decisions at a basic level. In this manner, the US will be forced to revise the fundamental premises of its analysis, and bring its practice for all privatization decisions into conformance with the SCM Agreement.

4.7 In addition, Brazil supplements the discussion in the First Submission of the European Communities ("EC") with additional legal analysis that applies to the underlying dispute between the US and EC, as well as other circumstances. In particular, Brazil addresses the general requirement under the SCM Agreement to identify and measure benefits of a subsidy on a basis that is specific to the company under investigation, during the period of investigation. Brazil identifies support for this requirement that supplements that addressed in the EC submission.

4.8 With respect to the impact of an arm's-length privatization, Brazil adds to the discussion in the EC submission by observing that it is always critical to focus on the "ownership relationship" between an owner and an asset (or the assets of a company in a privatization) and the terms of acquisition in determining whether a benefit exists. An examination of the owner/asset relationship is the only logical form of analysis that can support a determination that a benefit does or does not exist.[6] By framing its analysis in these terms, the panel's decision will address the underlying issues in this proceeding, and lay a foundation for any future consultations and disputes between the US and other WTO Members related to privatization.

2. Framework for analysis of pre-privatization subsidy benefits

4.9 The question before this panel is most simply stated as whether the benefits of financial contributions made by a government or government entity to a company continue after the company that received the financial contribution has been privatized. Specifically, the question is whether the benefits of government equity infusions in government-owned companies survive the privatization of the government owned company when that privatization transfers ownership or assets to non-government entities at a fair market value.

4.10 While Article 14 of the Agreement is intended to focus on the calculation of the amount of the subsidy based on the benefit to the recipient, it is instructive in providing guidance as to what is and what is not a benefit. In terms of govern-

[6] After a change in ownership, the US applies countervailing duties primarily to pre-privatization grants and equity infusions. Thus, for the purposes of this submission, Brazil focuses on the benefits of these two forms of subsidies.

ment provision of equity capital, paragraph (a) provides that a benefit is conferred only when such provision of equity capital is on terms "inconsistent with the usual investment practice of private investors." This benchmark of consistency with market driven policies is confirmed by paragraphs (b), (c) and (d) which all reference "commercial" or "market" criteria as the basis of determining whether a benefit has been and continues to be conferred.

4.11 With respect to some categories of benefits, the event that extinguishes the benefit is obvious. For example, if the benefit is in the receipt of below market interest on a loan from the government or a government entity, there is a benefit only so long as the loan is outstanding and the interest charged on that loan is lower than the interest that would be charged on a comparable commercial loan. Thus, the benefit ends if either the interest on the loan principal is altered to reflect commercial interest rates or if the loan itself is no longer outstanding.

4.12 The value of the benefit will, in turn, vary depending on the amount of the principal which is outstanding and the relationship between the below market interest rate and the commercial interest rate. Thus, the existence of benefits and the value of the benefits conferred can change with events which occur after the initial action by the government or government entity conferring a benefit.

4.13 A simple example, using a pencil, illustrates how benefits and the party receiving the benefits can change over time. If a Government gives Company A a pencil, the benefit to Company A is the value of the pencil. If Company A sells the pencil at fair market value to Company B, the benefit of the Government's action still resides with Company A not Company B, since A has retained the value of the pencil in the form of cash and B has paid Company A the same amount for the pencil as it would have paid on the open market. The asset has been transferred, but the benefit remains in Company A.

4.14 Let's assume that rather than selling the pencil immediately, Company A uses half of the pencil and then sells the remaining portion of the pencil to Company B. Company B again pays fair market value, but it pays only fair market value for half a pencil since that it all it is receiving. Company B has received no benefit because it has paid market value for the pencil. Company A has a residual benefit - the value received from Company B for half the pencil. The remainder of the benefit has been used in the form of the half of the pencil which Company A has already consumed.

4.15 Finally, assume that Company A never sells the pencil but uses it until it is finished. Under this scenario, Company A has received all of the benefits. However, after finishing the use of the pencil, no additional benefits exist. To assume benefits continue after the pencil is fully used would be to attribute benefits to Company A in terms of receiving the pencil in excess of the value of the pencil.

4.16 The analysis with respect to government provision of equity capital is really no different than the analysis of benefits where the government provides funding, goods or services at no cost or below cost to an entity. Rather than getting nothing in exchange for the funding, goods or services provided, the Government gets a share of the company and, therefore, of its assets and liabilities. In essence, it simply owns a share of the benefits received by Company A as a result

of the funding, goods or services provided by the government on terms inconsistent with commercial considerations.

4.17 Let's assume, for example, that in the above example Company A is owned by the government and receives an equity investment equivalent in value to a pencil. Company A uses the equity investment to buy a pencil. Company A then sells the pencil to Company B at its market value. The benefit remains in Company A. It has simply converted a cash infusion in terms of equity into an asset and then reconverted the asset into cash by selling that asset. Company B has not received any benefit because it paid market value for the asset it acquired from Company A.

4.18 Let's further suppose that the government has decided that it no longer wants to own Company A - i.e. it is going to privatize the company. Company A's only asset is the pencil and it has no liabilities. In the privatization, the equity shares of Company A are valued at the net of its assets and liabilities, in this case the value of the pencil. Rather than purchase the pencil itself, Company B purchases all of the equity in Company A and pays the market value of its net worth (again, the value of a pencil) to acquire the equity. Company B has received no benefit in that it has paid the fair market value for its equity purchases based on the underlying value of the company whose shares have been bought. The benefit previously conferred on Company A has been transferred to the prior shareholders in Company A through the purchase at market value of the shares in Company A. Because Company A was owned by the government, in effect the benefit has been returned to the government.

4.19 While the case being examined by the panel is more complex factually than the pencil example, the pencil example illustrates the crucial point in any analysis of benefits under the Agreement: whether you purchase an asset (the pencil) or the ownership interest in an asset (i.e. equity), neither the asset (the pencil) nor the ownership interest in the asset (the equity in the company which owns the asset) continues to have a benefit conferred on it if the new owner has paid market value for the asset or the ownership interest in the asset. The benefit remains with the original owner of the asset or the ownership interest in the asset if the new owner pays market value to the original owner.

2. Brazil's privatization programme was structured to eliminate pre-privatization subsidy benefits

4.20 The privatization issue is of particular importance to Brazil, since it has undertaken a vast privatization programme, including the privatization of all formerly state-owned steel mills. The pre-privatization equity infusions to the steel mills were investigated beginning in 1983. The benefits of these equity infusions after privatization were first investigated by the US authorities in 1992/1993 and determined to remain in the privatized company. This investigation involved the first of the privatized mills, USIMINAS. The US has preliminarily reached the same conclusion in a current investigation of USIMINAS and two other privatized mills.

4.21 Ironically, the Brazilian privatization programme was structured with the specific intention of eliminating any benefits from the Government to the privat-

ized steel mills. That is, the process devised by the Government ensured that the mills were sold at a market determined value. This result was achieved through a careful valuation process involving studies by two independent groups, the setting of minimum prices for each mill based on these studies, and the use of an auction process to ensure that market forces ultimately determined the price for each mill.

4.22 The current owners do not enjoy any benefits, having paid a market determined price for the mills. To the extent that any residual benefits of government equity infusions existed at the time of the privatization, these benefits were included in the valuation of each mill and, therefore, in the price paid. As such, no advantage was conferred on the new owners.

4.23 If pre-privatization provisions of equity capital were deemed to confer a benefit because the investment decision was inconsistent with usual investment practices as required by Article 14(a) of the SCM Agreement, then the sale of equity based on investment decisions which are consistent with usual investment practices by definition cannot confer a subsidy. In ensuring that the new owners of the mills paid a market determined price for the mills, Brazil ensured that no benefits of equity infusions in the pre-privatized companies continue to benefit the privatized companies.

3. A plain interpretation of the provisions of the SCM Agreement requires an affirmative finding of the conferral of a benefit to a company during the relevant period

4.24 As its initial defence, the US argues that it is not required under the SCM Agreement to recognize the absence of benefits to the purchaser of an asset or company in an arm's length transaction. At the heart of the US position is the premise that under SCM Agreement Articles 1 and 14, there is no requirement to analyse the existence and value of a benefit after the initial financial contribution. The US interpretation of Articles 1 and 14 is without support. A plain interpretation of these Articles demonstrates that the SCM Agreement requires a finding and measurement of a benefit to a company during a particular period.

4.25 Article 1 of the SCM Agreement establishes the very foundations of any determination to apply countervailing measures. As a precondition to a countervailable subsidy determination, Article 1 requires three affirmative findings:

- a financial contribution by a government (Article 1.1(a)),
- that the financial contribution thereby confers a benefit (Article 1.1(b)); and
- that the first two elements above were provided on a specific basis (Article 1.2).

4.26 The second finding involves an obligation on the part of the investigating authority to determine whether the company subject to investigation received a countervailable benefit during the period of investigation. It is not sufficient, as discussed in the EC submission, to find that a benefit is conferred to some other company, during some other period, and presume that the benefit is conceptually

transferred to the company subject to investigation, and this transferred benefit is received during the period of investigation. With each company and investigation, the investigating authority is obligated to find a continuing nexus between the underlying financial contribution, and a benefit to that company during that period.

4.27 The US position relies on the view that there is no obligation to find that the firm under investigation was the recipient of the subsidy. See e.g., paragraph 156 of the US First Submission. The primary argument is that the "ordinary meaning" of Article 1 does not require a finding of benefit specific to the company subject to investigation, during the period of investigation. Rather, the US argues that Article 1 permits Members to detect and measure subsidy benefits only as of the moment of subsidization, and then allocate benefits based on that initial finding, regardless of subsequent developments.

4.28 Thus, the US position is premised on a limited interpretation of the phase "a benefit is thereby conferred" to refer to the company that initially receives the subsidy, and the period in time when the financial contribution is initially made. The US argues that Article 1.1(b) obligates Members to find and measure the conferral of a benefit only as of the moment of the financial contribution.

4.29 The US position is in direct conflict with interpretations by the EC, Brazil and other members, that contemplates the detection of the conferral of the benefit (i.e., the continuation of the benefit) to the company subject to a particular investigation, during the relevant period of investigation. This difference in the interpretation of the intended timing of the duty under Article 1.1(b) separates the US from the EC, Brazil, and other WTO Members.

4.30 The panel should resolve this dispute as to the meaning of Article 1.1(b) by considering several relevant factors.

4. Under the SCM Agreement, CVD investigations focus on benefits to companies during particular periods of time, regardless of the timing of the conferral of underlying subsidies

4.31 The US is proposing an interpretation of "is thereby conferred" that is inconsistent with the mechanics and operation of the SCM Agreement, as well as other similar agreements, such as the Agreement on Implementation of Article VI of the GATT 1994 ("AD Agreement"). The US interpretation ignores the fact that CVD investigations in the US (and in most other Member countries), are company specific, and period specific.[7] The initial task in a CVD investigation is to focus on whether a particular company, during a particular period, benefited from subsidies. If so, the next step is to formulate a methodology that measures precisely what the benefit was during a particular period.

[7] Although more than one company may be involved in a CVD investigation, the US calculates a company-specific CVD rate for each company subject to investigation.

4.32 The ultimate objective in calculating the benefit conferred during the particular period is to identify a countervailing duty that is properly correlated to the underlying benefit. The fundamental duty at the core of Part V of the SCM Agreement - to calculate a countervailing duty that offsets no more than the benefit to a company's exports. All actions pursuant to Article 1 and 14 must be directed towards this objective. The approach proposed by the US invites an unjustified separation between the actual benefit conferred to a company during a particular period, and the calculation of a countervailing duty to be applied to the exports of that company.

4.33 Interestingly, in its implementation of the SCM Agreement, US law agrees with the interpretation of the EC, Brazil and other WTO Members. Section 703(b)(1) specifically requires a determination that "a countervailable subsidy is being provided with respect to subject merchandise" (emphasis added). Thus, US law recognizes that there must be a present benefit to the specific merchandise under investigation.

4.34 Given this immediate focus on a specific period, on a specific company, the phrase "a benefit is thereby conferred" can only refer to the company subject to investigation, during the period of investigation. It does not matter if the period investigated is contemporaneous with, or significantly after, the time the actual subsidy was bestowed. The broader, more obtuse, interpretation of "is thereby conferred" advanced by the US is simply not credible.

5. The SCM Agreement has a bias against irrebuttable presumptions of fact over periods of time

4.35 The US interpretation is inconsistent with other aspects of the SCM Agreement and other similar WTO agreements. The SCM Agreement, like the AD Agreement, circumscribes limited areas in which Members may make determinations, and then presume that this determination is valid for a period of time. With respect to most determinations, the SCM Agreement, like the AD Agreement, contemplates a consideration and incorporation of all relevant and current information in making a finding.

4.36 Thus, there is a pervasive bias in the SCM Agreement against presumptions that endure unchallenged over time. However, the US interpretation inserts such an unchallengable presumption in the finding of a benefit. In the underlying proceeding, the US argues that its finding and measurement of a benefit should not be revisited for 18 years, the amortization period for the benefits received by British Steel Corporation before its privatization.

4.37 The most telling example of a bias against the extended validity of a factual presumption is the requirement for regular reviews. The SCM Agreement, like the AA contemplates regular reviews of CVD findings. Such reviews are provided for in Article 21 of the SCM Agreement. In each of these reviews, the validity of the prior CVD findings is revisited. From review to review, the flow of a benefit may change, a subsidy may be withdrawn, and the value of the company's sales may change (thereby altering the ad valorum calculation), to name a few of the factors examined in a review.

4.38 The longest presumption that is permitted under the SCM Agreement is the presumption of injury. However, under SCM Agreement Article 21.3, even this presumption must be revisited at least every five years.

4.39 In this context, the unacceptability of the US suggestion that it can make a benefit flow determination at one point in time, and presume that nothing changes to interrupt this flow over a period of 15-20 years, is plain. As a result, the US position that Article 1.1 allows it to make an initial assessment of the existence and value of a benefit is inconsistent with the mechanisms contemplated by the SCM Agreement. The disciplines of the SCM Agreement require current determinations, that incorporate all of the relevant information available to the investigating authority at the time of each determination, and a valuation of such benefits at such time.

6. The US tries to support its interpretation of SCM Agreement Articles 1 and 14 by mischaracterizing the task of identifying and measuring a benefit to the company subject to investigation during a particular period

4.40 The US tries to exaggerate the task and duties involved in complying with Articles 1.1 and 14. Based on this exaggeration, the US has claimed that the administration of CVD investigations under the SCM Agreement would become impossible if the EC's position is accepted. The US position is pure hyperbole, and should be recognized as a purposeful effort to overstate the analysis required by the position advanced by the EC and Brazil.

4.41 The US complains that a "continual benefit analysis" would result in a "fundamental change" that would "seriously undermine the effectiveness of the SCM Agreement." Paragraph 22 of the US Submission. The US argues that this would require a continual inquiry into the "effects" of a subsidy.

4.42 Brazil (and presumably the EC) has never stated that a continuing "effects" test is required under Articles 1 and 14 of the SCM Agreement. As a threshold matter, an effects test suggests tracing the actual uses by a company of the financial contribution.[8] The EC in its first submission, and Brazil in separate proceedings, have never equated the Article 1 benefits analysis with an effects test. The benefit analysis simply examines whether the company subject to investigation enjoyed a benefit during the investigation period. An effects analysis would inquire further into how the company utilized that benefit. The panel should ensure that it does not permit the US to mischaracterize the position of Brazil, and the EC.

4.43 Second, from the standpoint of administrative burdens, the interpretation of Articles 1 and 14 is far less complicated than conveyed by the US and contrary

[8] For example, if a company received a grant of 1,000, an effects analysis would theoretically determine whether the company spent the 1,000 on a large unscheduled party, or if it used the 1,000 to acquire an advanced machine that directly benefited its production.

to its current practice. Articles 1 and 14 require an affirmative determination that a benefit is conferred to the company subject to investigation, during the period of investigation. This does not entail an initial assessment, and then a "re-identification" as the US suggests. There is no "second time" that the assessment must be made. Rather, in any given investigation, the authority identifies the potential subsidy "event" in the past, and determines whether benefits flow from that subsidy to the company subject to investigation, during the period of investigation. This examination takes into consideration the initial subsidy event, and any relevant events subsequent to the subsidy event.

4.44 A countervailable loan provides a useful example. In any given investigation, in any given period, an investigating authority will identify the amount paid under the terms of the loan, and compare this to the amount that would have been paid during the same period for a loan based on market terms. However, this exercise involves an assessment of current information (i.e., what was actually paid compared to what would have been paid during the relevant period). The actual payments of the company, and fluctuations in the underlying interest rate (e.g., LIBOR), will influence the benefit to the company during the particular period. If the loan has been paid back and liquidated prior to a period of investigation, then there is no benefit during that period. As such, there is no initial benefit calculation, and then another bothersome "second" calculation. The benefit assessment for any investigation, by necessity, correlates to the period of investigation, and results in a finding specific to the company and the period of inquiry.

4.45 US practice acknowledges this need to consider subsequent events in its benefit analysis. For example, if a grant is completely repaid by a company to the government, then the US would not find that a subsidy was conferred after the repayment. As discussed above, if a loan was repaid and liquidated prior to a period of investigation, the US would not and could not find that any benefit was conferred to the company after the loan repayment. Prior to 1992, the US employed an approach of measuring the benefits of equity infusions named the "rate of return shortfall methodology." This methodology compared the rate of return of a recipient of an equity infusion with the average return for similarly situated companies. This methodology required an examination of events subsequent to the initial infusion event to determine whether a benefit was conferred during the period of investigation. All of these examples demonstrate that the US, like other Members, considers "subsequent events" in determining whether a benefit is conferred to a company during a specific period.[9]

4.46 The basic task in detecting a benefit is no different with respect to equity infusions. It may be necessary and appropriate to amortize certain benefits over time as an estimate of the benefits theoretically conferred during a particular period. However, the investigating member has to recognize that the benefit amortization is based on certain presumptions (i.e., that there will be no significant changes to the company or the financial contribution) and is only appropriate in

[9] In paras. 238-240 of its First Submission, the US discusses other forms of "subsequent events" it considers relevant to its subsidy benefit analysis.

certain circumstances. That is, the Member has a duty, under Article 1 and 14, to consider (and incorporate into its benefit analysis) events and developments that require it to question the presumption of an uninterrupted continuation of benefits unreasonable.

4.47 If circumstances exist, as they do after an arm's-length privatization, to undermine the use of a presumed uninterrupted benefit flow, then the investigating member simply has to tailor its analysis to the facts and circumstances of the proceeding. However, this does not involve a "first" and "second" benefit flow analysis. Rather, it simply requires the investigating member to use an appropriate analysis in the "first" instance.

4.48 In effect, the US is stating it should always invoke its uninterrupted benefit stream conclusions first, and then analyse its applicability later if requested (thereby requiring multiple benefit analysis). The EC and Brazil do not argue that this "shoot first, ask questions later" approach is required under the SCM Agreement. Their position is that, in any investigation, in detecting the existence and value of a benefit to any given company, in any given period, the investigating member must choose a form of analysis that considers all of the facts and circumstances before the authority. There is no requirement, as the US suggests, to make multiple benefit determinations.

4.49 In the privatization circumstances underlying this dispute, it is incorrect in the first instance to presume the circumstances exist to apply blindly the US benefit stream calculation. Thus, the "second" benefit analysis characterized by the US is necessary only because the first analysis did not comply with the SCM Agreement. If the US applies the correct analysis, at the outset, there is no need for multiple benefit determinations.

7. The SCM Agreement does not authorize members to circumvent fundamental duties and obligations due to claimed "administrative" burdens

4.50 The US position is also problematic because it relies on a proposition unsupported by the SCM Agreement. In referring to the burdens associated with the benefit analysis proposed by the EC, the US presumes that the SCM Agreement authorizes a Member to circumvent a continual analysis of benefits to a company due to the administrative difficulties.

4.51 The determination of a benefit under Article 1, and the quantification of a benefit under Article 14, are the two most fundamental obligations under the SCM Agreement. Moreover, Article 10 states that Members "shall take all necessary steps to ensure that the imposition of a countervailing duty" is in accordance with the SCM Agreement.

4.52 Contrary to the US position, there is no offsetting provision in the SCM Agreement that authorizes a Member to sacrifice these fundamental obligations to accommodate offsetting administrative burdens on the part of the investigating Member. The US request to excuse clear duties due to administrative burdens is without support in the SCM Agreement.

8. There is no subsidy benefit conferred on the purchaser in an arm's length sale or privatization

4.53 Recognizing the need under SCM Agreement Articles 1 and 14 to detect and measure a benefit specific to a particular company, during a particular period, the relevant inquiry is what are the effects of a privatization or asset sale prior to the investigation period?

4.54 The position of the EC and Brazil is that under certain circumstances, the sale of an asset or company interrupts the flow of benefits to the purchaser. Specifically, when purchasers acquire a company or an asset in an arm's-length transaction, reflecting market conditions, no benefit is transferred to the purchaser as the new owner of the company. If no benefit is conferred to the owners, the company as a whole does not receive a benefit.

9. The benefit from a grant or equity infusion relates to the receipt of assets at reduced or no costs

4.55 Prior to the consideration of the impact of privatization, it is useful to isolate precisely the actual benefit associated with a financial contribution such as a grant or a countervailable equity infusion. The benefit of a grant or infusion is such that a company and its owners receive assets, due to government action, on terms less costly than the company would have incurred based on market conditions.

4.56 The discussion in the EC First Submission addresses this directly. See Example 1 in Paragraph 51 of the EC's First Submission. In that example, Company A receives a financial grant of 100, and then purchases a machine worth 100. The benefit to Company A is plain. Company A and its owners now have 100 in assets (either in the form of cash at the time of the infusion, or the machine after the purchase) at no cost.

4.57 The advantage to Company A derives from the terms of its acquisition of the machine. Company A obtained the machine, and now owns the machine, without the costs other companies in the market incur to obtain the same machine.[10] If every company in the country were given 100 (or the same machine worth 100) by the government at the same time, then there would be no countervailable benefit. It is only the comparative advantage of owning the machine worth 100 with no costs that provides the benefit.

4.58 In this sense, the analysis of the specificity requirement of a benefit in SCM Agreement Article 1.2 is linked to the requirement that the subsidy be spe-

[10] The example changes only slightly if the original government contribution is in exchange for equity. Unlike the receipt of a grant, there are "costs" associated with the equity capital. These include the obligation of the company to respond to the demands of the government-investor for a return on its investment. In addition, the government investor retains a right to sell its shares. Thus, the benefit in these circumstances is measured by the difference between these costs, and the costs the company would have incurred but for the infusion to obtain the same 100 in capital (either by securing a loan, or issuing debt instruments).

cific.[11] Since Article 1.2 applies to a "subsidy," it embraces both elements of a subsidy (i.e., the financial contribution, and the benefit). Thus, a "benefit" must be specific in that it provides an advantage or privilege to a company and its owners that was not available in the market or otherwise to other companies. If same financial contribution subject to investigation is generally available to other companies, and does not thereby provide a comparative advantage to the company subject to investigation, there can be no finding of a countervailable benefit within the meaning of Articles 1 and 2 of the SCM Agreement.

10. The same analysis of ownership relationship is appropriate after an asset is sold

4.59 The same analysis of the terms of acquisition is required after an asset is sold in an arm's length transaction. An analysis of the dynamics of an arm's length sale of assets demonstrates that a benefit is not thereby conferred to the new owner of the asset or assets after the sale.

4.60 In the EC example 1, Company A subsequently sells the machine for its fair market value of 100 to Company B. Company B and its owners do not receive any conceivable benefit due to its ownership relationship with the machine. Company B did not acquire any economic advantage over its competitors or any other company in purchasing the machine. Thus, Company B does not enjoy any advantage in using the machine to manufacture products. In short, Company B's ownership relationship with the machine is such that it has no market advantage in acquiring, owning or operating the machine.

4.61 Although the example and analysis is plain, it is important to identify the governing principle that determines whether a benefit is conferred to Company B. It is the terms of Company B's acquisition and ownership of the machine that are dispositive in detecting a benefit. Since Company B acquired the machine at a cost no less than it (or any other company) would have paid to acquire the same machine in the market, Company B receives no competitive benefit in purchasing the machine. Its ownership relationship with the machine is such that it incurs costs equal to the costs of its competitors and other companies in the market.

11. The same benefit analysis applies when all of the assets of a company are sold

4.62 In the arm's length privatization of a company at a fair market price, the analysis is unchanged. An arm's length privatization is the sale of all of the assets (and liabilities) of a company through the sale of shares in the company. In many countries, including Brazil, a basic minimum fair value price is established above which the company must be sold.[12]

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[11] Pursuant to SCM Agreement Article 1, a subsidy is countervailable only if it is "specific" within the meaning of SCM Agreement Article 2.

[12] In most companies, the rights of ownership of common shares in a company are broad. They include the right to decide how to operate the assets of the company (through voting rights), the

4.63 In an arm's length, fair market privatization, the new owners of the company compete with other potential owners for shares in the company. Ultimately, the new owners acquire shares in the company by virtue of their willingness to pay the highest price for the shares of the privatized company. Thus, the new owners in a privatization meet two conditions: they pay at least the market value for a company, and their purchase is an arm's length transaction.[13]

4.64 Recalling that any benefit is derived from the ownership relationship of the owner with the newly acquired asset or assets, the focus of analysis, after privatization, should be on the new owners of a privatized company, and whether they received any benefit in purchasing the company. Because the new owners paid the market value for the company, there can be no benefit to the new owners of the company.

12. Arguing in the alternative, the us fails to defend its conclusion that pre-sale benefits pass through to the purchaser after an arm's length transaction

4.65 In its submission, the US apparently recognizes that it is unlikely the panel will accept its argument that no current analysis of the benefits to a company during a particular is required under SCM Agreement Articles 1 and 14. Thus, the US argues, in the alternative, that even if a current benefit analysis is required under the SCM Agreement, an arm's length sale or privatization does not eliminate the conferral of benefits to the recipient. In support for its position, the US advances three positions. All are without merit.

13. The SCM Agreement does not focus on "productive assets" or "manufacturing" when assessing whether a subsidy benefit is conferred and received

4.66 First, the US argues that there is an important distinction between the recipients of a subsidy (i.e., owners of a company) and the productive assets of that company at the time the subsidy is received. According to the US, "it would seem to be that the productive assets - not the owners - would be the determinative factor" in identifying the existence of subsidies. US Submission at 150.

4.67 Based on this, the US argues that changes in ownership of the assets are irrelevant to a subsidies analysis. Subsidy benefits somehow remain with the assets. The US position ignores the obvious flow of a benefit within a company, and ironically attempts to focus only on the "effects" of the benefit within the company.

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rights to company profits (through dividends), and the rights to the assets of the company if the company is sold or otherwise liquidated.

[13] Although the mechanics of a privatization can vary from country to country, the benefit analysis is essentially the same as long as the company is sold in an arm's length transaction, for a market determined value.

4.68 A subsidy is clearly bestowed initially on the company, in the form of a benefit to the owners of the company. If a government provides the company with an unrestricted grant of 100, it is the owners of the company that decide how that 100 will be used.[14] The owners can decide to donate the 100 to charity, distribute the 100 to the directors of the company as a bonus, distribute the 100 to themselves as owners of the company, employ 10 workers for a year to do nothing productive or useful for the company (i.e., an indirect way for the government to provide social welfare benefits to its citizens), or invest the 100 in a machine to be used for future production. Thus, the owners are the direct recipient of the benefit of the subsidy. They then decide how to apply the benefit.

4.69 If the owners decide to use the subsidy to benefit the "manufacture, production, or export" of a product, then an observation can be made about the application of the subsidy benefit to the productive assets of the company. However, it would be wrong to suggest this application occurs without some initial benefit to the owners or recipients of the subsidy.[15] The application of the subsidy only occurs after the receipt.

4.70 Last, if the subsidy benefit is applied to manufacturing, then the products manufactured by the company are assumed to benefit from this subsidy. Ultimately, a countervailing duty is designed to offset this benefit.

4.71 The US ignores these steps from the bestowal of the subsidy to the recipient, to the presumed benefit of the subsidy to a product manufactured. The US simply focuses on the productive assets of a firm, and argues that a benefit analysis properly focuses on productive assets. This focus clearly ignores the initial steps involving the receipt and application of a subsidy. Any decision that a company is currently benefiting from a subsidy that ignores these initial steps. The US approach overlooks the essential component of a finding that a subsidy has been conferred to a company in accordance with SCM Agreement Article 1.

4.72 The US identifies several provisions in the SCM Agreement and the GATT that supposedly support its position. In particular, the US argues that SCM Agreement Articles 10 and 19.4 demonstrate that the focus on the SCM Agreement is on products and production and not the receipt of a benefit. The US confuses the purpose of the referenced articles.

4.73 For example, Articles 10 and 19.4 address levying duties on a "product." Clearly the application of countervailing duties is on products sold. This is the mechanism authorized by the SCM Agreement for offsetting a subsidy benefit. Articles 10 and 19.4 address this mechanism only.

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[14] In this example, and elsewhere, the decision-makers (normally the directors and officers) of a company are presumed to be act in accordance with the direction and wishes of the owners. As a result, the example is not undermined by an observation that the directors or officers would decide how to use the subsidy.

[15] Ironically, in arguing that it is not required to analyse the "effects" of a subsidy, the US is acknowledging this essential relationship between the "receipt" of a subsidy, and the application of the benefit from the subsidy. The US argues it is correct to always presume that the subsidy has been applied to the production of merchandise without analysing the subsidies actual effects.

4.74 However, the process of offsetting a benefit is subsequent to the initial finding of the receipt of a benefit required by Article 1. The finding of the receipt of a benefit is a precondition to the collection of countervailing duties on products exported to the investigating country. Thus, the reference to "levying duties on products" in Articles 10 and 19.4 has nothing to do with the initial finding of a benefit required by Article 1.

4.75 Similarly, the reference in Article VI of the GATT 1994 to the "manufacture, production, and export" does not support the US position. This reference clearly limits the application of countervailing duties to no more than the subsidy found to benefit the manufacture of a product. This limitation does not undermine the observation that a company and its owners must receive a subsidy before it could possibly be applied to benefit the manufacture of a product. The finding that a benefit is bestowed to a recipient (pursuant to Article 1) is a precondition to a finding that the subsidy then benefited the manufacture, production or export of a subsidy. The bestowal and receipt is required as a threshold matter to the application of countervailing duties.

14. The SCM Agreement does not provide a mechanism to address all actions perceived by members to "distort the market"

4.76 The US argues that a focus on the new owners of the assets sold or privatized would not take into account "market distortions" caused by the underlying subsidy. The US argues that if an arm's length transaction does not confer a benefit to the new owners and new company, then a market distortion (e.g., the creation of certain steel production capacity) will remain unredressed. The US suggests that any methodology that does not allow Members to address these macro-economic effects of a subsidy is not consistent with the objective and purpose of the SCM Agreement. Paragraph 185 of the US Submission.

4.77 This "creation subsidy" argument is based on confusion between macro-economic concerns and the disciplines and requirements of the SCM Agreement. The SCM Agreement does not provide Members with a broad-based authorization to redress actions the Member feels distort the market. Rather, it allows a Member to apply countervailing duties to the products of a particular company, during a particular period, only after certain conditions are met.

4.78 For example, if a government provided a grant of 100 to every company in its country every year, this may have market distorting effects (in the global sense) to certain industries. This 100 may be used to expand capacity in the country's steel industry (an industry the US submission describes as being plagued with overcapacity). However, since this 100 grant is generally available, there is no "subsidy" under Article 1. No countervailing duties could be applied.

4.79 The example shows that the SCM Agreement is not designed to address all forms of so-called market distortions. Part V of the SCM Agreement is intended to deal with one action only: a financial contribution, that confers a benefit to a particular recipient during a particular period analysed, on a specific basis.

4.80 The US discussion also appears to confuse injury-related analysis with Article 1 subsidy benefit analysis. In its "rental apartment" example, the US concedes that whether the purchaser of a subsidized asset receives a commercially meaningful advantage" is "open to conjecture." US Submission at paragraph 192. The US states, nonetheless, that it is important to focus on the continuing "adverse effects" after the arm's-length sale. The Article 1 requirement of finding a benefit to the company subject to investigation authorizes no parallel consideration of the adverse effects of a prior transaction involving the assets purchased. Article 1 is far more limited, and contemplates the finding of the bestowal of a subsidy on a company subject to investigation. Any consideration of adverse effects is appropriate only within the terms of SCM Agreement Article 15.

4.81 Thus, the US "creation subsidy" argument does not provide support for its position. Instead, this argument reveals that the US privatization methodology is a practice that transcends the limitations and disciplines of the SCM Agreement. Ironically, the US rationale depends on an "effects" test, the type of test it claims the EC is relying upon, and not a "benefits conferred" test, the type of test advocated by the US

15. The US wrongly interprets SCM Agreement Article 27.13

4.82 The US argues that SCM Agreement Article 27.13 provides support for the proposition that Members may countervail prior subsidies after a privatization. US Submission, Paragraph 120 The US states that since that Article carves out an exception to when pre-privatization subsidies may be addressed, the implication is that outside that exception, pre-privatization subsidies may be addressed under both Parts III and V of the SCM Agreement.

4.83 The US acknowledges that Article 27.13 only refers to Part III. Thus, it can only be presumed that the negotiators purposefully excluded any reference Part V of the SCM Agreement. Thus, the relevance of Article 27.13 is dubious, at best.

4.84 To the extent it is relevant, it is not based on the US interpretation. Article 27.13 describes circumstances in which a Member is precluded from addressing pre-privatization subsidies of another Member. It does not follow that outside those circumstances, all pre-privatization subsidies are countervailable. Rather, the correct interpretation is that absent those circumstances, Members may investigate whether pre-privatization subsidies are passed through to the post-privatization owners.

4.85 Brazil, and presumably the EC, have never argued that a Member cannot even investigate whether pre-privatization subsidies somehow benefit the purchasers after a change in ownership. To the contrary, it is entirely appropriate to investigate the terms of the change in ownership to determine whether the sale occurred in circumstances that conferred a benefit to the new owners. As stated in the EC submission, a sale of a subsidized company at a price below its market value, in a non-competitive bidding environment, could provide the basis for a finding that the pre-sale subsidies were passed through to the purchaser. An investigation into the terms of the sale would identify this.

4.86 It is important to note, however, the distinction between the investigation of a privatization, and the automatic conclusion that the privatization conferred a benefit to the new owners. The US argues wrongly that Article 27.13 authorizes the latter conclusion. A proper legal interpretation clearly supports the first conclusion. To the extent Article 27.13 has any relevance at all to countervailing duty investigations, it is that an investigation into the form of a privatization or change in ownership is allowed in circumstances not excepted by the Article.

16. Under any analysis, the US privatization "payback" methodology is flawed

4.87 On the one hand, the US defends its privatization position by stating that it is precluded from analysing the flow of benefits from a subsidy after the government's financial contribution. On the other hand, the US does factor privatization into its CVD determination with a "payback calculation." The US payback calculation is flawed in several ways. Brazil addresses below only the most severe infirmities in the US approach.

4.88 First, the payback calculation does not analyse the actual benefits to the post-privatization company under investigation during the period of investigation. The payback calculation purports to measure the revenue "returned" to the government as a result of an arm's-length sale. However, a benefit exists only when it is determined that a person or company acquired an asset on terms inconsistent with market conditions or costs. This focus on the flow of capital to the government at the time of privatization is irrelevant to the benefit analysis discussed above.

4.89 The revenue paid to the government, and its relationship to the historical values of the government's investment, is irrelevant to the comparative benefit analysis focused on the new owners. Whether the government has, or has not, recovered the value of its investments has no impact on whether the new owners acquired their shares in the company (i.e., their right to operate the assets of the company) on a preferential basis. Even the limited privatization analysis of the US reveals that the US focuses wrongly on circumstances irrelevant to a benefit determination.

4.90 Second, to the extent payback is relevant, the US payback approach relies unjustifiably on the crude assumptions of a benefit stream calculation. The actual fair value of a company (or asset) provides information far more precise and useful in determining the value of subsidy benefits theoretically still embedded in the company at the time of privatization. The US methodology assumes it can identify the amount of subsidies repaid to the government through its calculations of gamma, and the net present value of all unamortized subsidies.

4.91 If a company or asset is sold at market value, however, this market value necessarily includes and reflects the actual (if any) benefits still remaining with the company at the time of privatization. A market value sale will, by definition, reflect the full value of the company, including all benefits residing with the company at the time of privatization. In this regard, the market value sale of the company or asset will necessarily result in the payback of all subsidy benefits still residing with the company at privatization to the government. Rather than em-

ploying the market analysis of the company (reflected in its privatization price), the US wrongly believes that its benefit stream amortization methodology, along with its gamma calculation, more accurately determine the value of the residual subsidies in the company at the time of privatization.

4.92 The US payback methodology provides additional evidence that the US analysis of privatization is inconsistent with the SCM Agreement because it does not focus on the benefit to the recipient, and fails to incorporate correctly market value information in determining a payback to the government as a result of privatization.

17. Pursuant to the standards of review of the dispute settlement understanding, the Panel should not accord any deference to US actions in determining whether the US has acted inconsistently with its obligations under the SCM Agreement.

4.93 The underlying dispute involves the application of countervailing duties under Part V of the SCM Agreement. Article 30 of the SCM Agreement dictates that the terms and provisions of the Dispute Settlement Understanding (DSU) apply to all disputes under the SCM Agreement. The panel's duty under the DSU is to determine whether there is an infringement of the obligations assumed under the relevant agreement. See e.g., Article 3.8 of the DSU.

4.94 In making this determination, this panel is not authorized to provide any deference to the permissibility of the US actions. That is, the standard of review described in Article 17.6 of the AD Agreement does not apply to these proceedings.

4.95 Article 17.6 was purposefully included in the AD Agreement, and at the same time purposefully excluded from the SCM Agreement. This is clear from the principle of interpretation cited by the US in their submission - inclusio unius est exclusio alterius (the inclusion of one is the exclusion of another). If the negotiators of the SCM Agreement intended the Article 17.6 standard of review to apply to disputes arising from the SCM Agreement, they would have included this standard of review in the SCM Agreement.

4.96 The US argues that the Declaration on Dispute Settlement Pursuant to the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 or Part V of the Agreement on Subsidies and Countervailing Measures from the Uruguay Round "Declaration") provides support for the proposition that the AA Article 17.6 standard applies to disputes arising from the SCM Agreement.

4.97 The legal analysis of the US is skewed. First, the very existence of the Declaration demonstrates that there was, and is, a current disparity in the standards of review between the SCM Agreement and the AA. If they were equivalent after the Uruguay Round, there would be no need for the Declaration. The Declaration represents a "need" for consistent resolution, despite the fact that the two agreements (after the Uruguay Round) had distinct standard of reviews. Thus, the Declaration reflects an intention and a pledge to take future action to

resolve this disparity. The Declaration, however, does not govern the actions of the panel. If it did, the Declaration would have been included as an article in the DSU.

4.98 Second, the US interpretation of the meaning of the Declaration is flawed. The Declaration simply states the need for a consistent resolution of disputes arising from anti-dumping and countervailing duty measures. It does not follow, however, that the WTO Members will ultimately decide this in favor of the Article 17.6 standard. It is equally possible that some other standard will be developed that will apply equally. This could include, among other things, the normal standard of the DSU. In short, there is no reason for this panel to presume or speculate whether the WTO Members will ultimately act on the Declaration, and if so, what uniform standard the Members will propose and adopt. In the interim, this panel must follow the dispute resolution terms in the SCM Agreement and DSU that govern this dispute.

4.99 For all of the foregoing reasons, the panel should find that the US has acted inconsistently with its obligations under the SCM Agreement. The US analysis of privatization is contrary to its obligations under SCM Agreement Articles 1 and 14 to find a benefit conferred to a company subject to investigation.

B. Mexico

Mexico made the following written arguments as third party:

4.100 Since the middle of the 1980s, Mexico has been pursuing an extensive privatization policy as part of its economic development programme. Mexico remains convinced of the importance of privatization and has maintained its efforts to that end, permitting and ensuring domestic and foreign investment in all kinds of public enterprises.

4.101 Unfortunately, the United States policy of applying countervailing duties to companies that are privatized has caused great concern to the owners of the companies in question and to potential investors. Not only is the uncertainty caused by this policy directly affecting the confidence of investors and reducing the real value of public enterprises, it is unfair to investors who have made bids for these assets.

4.102 The new United States regulations on subsidies maintain the policy applied by the country's authorities and tribunals whereby when a public enterprise is privatized, the benefits deriving from subsidies granted by the State are not extinguished. The investigating authority has considerable discretion in determining how the share of the subsidy that "subsists" following privatization is distributed. This regulation corresponds to a practice which has already affected Mexico in the past.[16]

4.103 In the statement of reasons for the regulations, the DOC reviews various comments, including some that were made to the DOC by the Government of

[16] See first submission of the EC, 27 April 1999, paras. 5-27, in particular 5-11, 26 and 27.

Mexico. The DOC qualifies the position that a privatization may extinguish the benefits of a subsidy as extreme. The DOC states that the definition of subsidy under United States law does not require it to determine whether and how a benefit exists following privatization, but only to make a determination at the point in time when the benefit was granted.

4.104 In general, the DOC's position on privatization could affect future exports of Mexican enterprises that have been privatized or are to be privatized. In particular, exports of carbon steel plate by the company Altos Hornos de México, S.A. (AHMSA) are currently seriously affected by the United States' maintenance of countervailing duties on account of subsidies granted prior to the company's privatization.

4.105 According to the letter and objectives of the Agreement on Subsidies and Countervailing Measures (ASCM), the application of countervailing duties must be transparent and based on the principle whereby an investigating authority must presume that privatization carried out between unrelated persons and at market value necessarily puts an end to any benefit granted prior thereto, and that it is up to the party claiming the contrary to prove how a financial contribution continued following privatization and specifically identify the benefit granted.

1. General observations

4.106 Mexico observes that some of the United States' arguments are based on its domestic legislation.[17] To justify this, the United States asserts that "it is an accepted principle of international law that municipal law and practice is a fact to be proven before an international tribunal, such as this Panel."[18] At the same time, it accepts that "US court decisions … are in no way binding on a WTO panel".[19] Mexico contends that interpretations by the United States tribunals of its domestic legislation are entirely irrelevant to this case, since they do not constitute precedent[20] for the Panel, much less "interpretations" under the Marrakesh Agreement Establishing the World Trade Organization (WTO Agreement).[21]

4.107 Moreover, the United States tries to justify its methodology for applying countervailing duties under Article 17.6 of the Anti-Dumping Agreement.[22]

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[17] First submission by the United States, 18 May 1999, in particular paras. 36-61.

[18] *Ibid*, footnote 8.

[19] *Ibid*, para. 61.

[20] In the case *Japan - Taxes on Alcoholic Beverages ("Japan – Alcoholic Beverages II")* (WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R), adopted on 7 November 1996, DSR 1996:I, 97, at 108, the Appellate Body found on page 18 of its report that since adopted reports were not binding except with respect to resolving a particular dispute, they should be taken into account when they were relevant to a dispute, and unadopted panel reports could provide useful guidance when they were relevant to the case at issue. In this case, we are dealing neither with panel reports prepared in the framework of the WTO dispute settlement mechanism, nor with disputes within the framework of the ASCM.

[21] Article IX.2 of the WTO Agreement limits the exclusive authority to adopt interpretations of the Agreement on Subsidies and Countervailing Measures to the Ministerial Conference and the General Council.

[22] See first submission of the United States, paras. 102-105.

Mexico considers that the fact that the Ministers recognized the need to ensure coherence in dispute settlement between anti-dumping measures and countervailing measures does not necessarily imply that Article 17.6 applies mutatis mutandis to the ASCM. The provisions of the Anti-Dumping Agreement are unique to that Agreement[23] and so long as Article 17.6 is not expressly incorporated in the text of the ASCM, the Panel is under no obligation to apply it.

2. *Legal arguments*

4.108 It is Mexico's understanding that the matter submitted to this Panel includes, inter alia, the following aspects of United States policy in respect of countervailing duties:

- Refusal to take account of "the privatization or change of ownership of the body receiving a subsidy, even if at a full market price, and to consider whether the subsidy still provides a benefit when assessing or reassessing the countervailable subsidy. Instead, the United States considers that the subsidy 'travels with' the assets when they are transferred."[24]
- Failure to justify or rationalize in the final determinations "what benefits continue to result from subsidies following privatization or a sale of assets at fair market prices."[25]

4.109 Mexico agrees with the EC and supports the arguments that the United States violated Article 10 of the ASCM in conjunction with Articles 19.1 and 14 of the ASCM, as well as Article VI of the GATT 1994, by imposing countervailing duties without first establishing whether there existed any subsidy.[26]

4.110 Similarly, Mexico agrees with the EC's position that even if there were a subsidy, the amount of that subsidy would be equivalent to zero, so that the application by the United States of any countervailing duty greater than that amount is "in excess of the amount of the subsidy" and violates Article 19.4 of the ASCM.[27]

4.111 It is our understanding that the United States' arguments are basically as follows:

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[23] In examining the concept of "measures" in the framework of the Anti-Dumping Agreement, in the case *Guatemala - Anti-Dumping Investigation Regarding Portland Cement from Mexico* ("Guatemala – Cement I") (WT/DS60/AB/R), adopted on 25 November 1998, DSR 1998:IX, 3767, para. 79, the Appellate Body found that Article 17.4 of the *Anti-Dumping Agreement* specified three types of anti-dumping measures: definitive anti-dumping duties, the acceptance of price undertakings, and provisional measures, adding that "we note that the language of Article 17.4 of the *Anti-Dumping Agreement* is unique to that Agreement."

[24] Request for the Establishment of a Panel by the European Communities (WT/DS138/3).

[25] Corrigendum to the Request for the Establishment of a Panel by the European Communities (WT/DS138/3/Corr.1).

[26] First written submission of the European Communities, in particular paras. 81-118.

[27] *Ibid*, paras. 119-138, particularly para. 119.

- The ASCM is silent on the question of privatizations, so that the Panel must accept as "permissible" the interpretations made by the United States of that Agreement[28];
- the investigating authority is required to determine the existence of subsidies, and ultimately, of benefits, only once;
- the subsidies affect the market in such a way that even if the company changes hands, they will continue to cause injury to the domestic industry of the importing Member.

4.112 Regarding the first of these arguments, Mexico contends that the ASCM does not need to expressly include the word "privatization". It is clear from the text of the Agreement that it regulates, inter alia, the application of countervailing duties in general. In other words, it regulates the procedure that an investigating authority must follow to that end. It is well known that the investigating authority is required to examine all of the elements enabling it to determine whether (i) through the effects of (ii) a subsidy there is (iii) injury to a domestic industry.[29]

4.113 Article 1.1 of the ASCM states that a "subsidy" shall be deemed to exist if there is a financial contribution by a government or any public body within the territory of a Member and a benefit is thereby conferred. In other words, in order to be able to apply a countervailing measure it is necessary first to determine that there is a subsidy. To determine that there is a subsidy, a benefit must be conferred. Thus, if there is no benefit, a Member is not entitled to apply a countervailing measure. That is, in principle, the contribution was extinguished upon privatization of the entity. The investigating authority cannot assume that the said contribution "travels with" the purchasing enterprise.

4.114 In a transaction between an independent, rational and informed seller and buyer, each looking after its own interest, the price of the transaction necessarily corresponds to its market value. For example, in the case of Mexico, the privatization of AHMSA took place by public tender.

4.115 Where an enterprise has been privatized at a price which corresponds to its full market value, this necessarily corresponds to the total price of the enterprise, including any advantage or benefit it may have. In other words, the market value paid absorbs the benefit that would have been conferred on the said enterprise, and the benefit therefore ceases to exist.

4.116 As regards the second argument, the United States asserts that in their ordinary meaning, sub-paragraphs (a) and (b) of Article 1.1 (drafted in the present tense) indicate that the investigating authority is not required to make a new benefit determination simply because the ownership of the original subsidy recipient has changed hands.[30]

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[28] First submission of the United States, particularly paras. 107 and 148.

[29] Articles 17.1(b) and 19.1 in particular.

[30] First submission of the United States, paras. 118 and 120. Mexico notes that the Spanish text of Article 1.1(a) and (b) of the ASCM is not drafted in the present tense, but in a subjunctive. This point is repeated in paras. 137 to 139, 149 and 156-158.

4.117 Mexico does not agree with this reasoning, since the foundation on which it rests is incorrect. To assume, as the United States has done, that the fact that Article 1.1 is drafted in the present tense provides sufficient reason to presuppose that the investigating authority is only required to make a finding of a subsidy benefit once, is to ignore the general context of the ASCM. Firstly, according to Articles 11, 17.1(b) and 19.1 of the ASCM, the determination that a subsidy exists must be made at least three times: on initiating the investigation, on making the preliminary determination and on making the final determination. That is, the investigating authority is required to determine the existence of a subsidy at least three times.

4.118 Moreover, Article 21 stipulates that a countervailing duty shall remain in force only as long as and to the extent necessary to counteract subsidization, and confers the right to request the authorities to examine whether the continued imposition of the duty is necessary to offset subsidization. This means that the authority must determine, for each examination, the existence of a subsidy - otherwise it will be unable to establish whether it is necessary to maintain the duty in order to offset the subsidy.

4.119 At the same time, Article 27.13 of the ASCM provides for benefits for developing country Members (such as Mexico) by not applying the provisions of Part III to direct forgiveness of debts or subsidies to cover social costs "when such subsidies are granted within and directly linked to a privatization programme". The United States argues in this connection that the wording of this article implies that all other privatizations are subject to subsidization.[31] This does not apply, however, to the case of the United Kingdom presented by the EC and certainly does not apply to the case of AHMSA, since these are not cases of subsidies granted within or directly linked to a privatization programme. Moreover, this provision excludes, by definition, the notion of "market value", so that the United States' interpretation whereby "to specify one thing is to exclude the other" is not applicable.

4.120 Finally, the United States asserts that subsidies do not apply to specific persons, but to the production or sale of products.[32] Similarly, it admits that it has been the practice of the United States Department of Commerce (USDOC) that subsidies can be extinguished by being repaid to the government[33], and subsequently admits that the amount of the purchase price simply affects the allocation of subsidies between seller and purchaser.[34] Lastly, it provides an example which implies that a subsidy affects the market irreversibly.[35]

4.121 These assertions by the United States are erroneous, since they are based on the assumption that the operation of a public enterprise follows a defined path, that it is only briefly affected for the purpose of the privatization and that it then continues its operations as though nothing had happened. They do not take ac-

[31] *Ibid*, paras. 151-160.
[32] *Ibid*, paras. 9 and 204.
[33] *Ibid*, para. 47.
[34] *Supra*, footnote 30, para. 55.
[35] *Ibid*, paras. 223-225.

count of the fact that like any other asset of the enterprise, a benefit (which may have taken the form of an industrial plant, machinery or equipment, or means of transport) has a determined price and that the purchaser that has paid the market price for the company (including the benefit) will want to recover the investment and generate profits. To that end, the purchaser may take decisions on production, operation and sales that differ completely from those taken by the company when it belonged to the government.

4.122 Furthermore, when a public enterprise is privatized and the purchaser pays the enterprise's market price, the seller (the government) in fact receives the money that the enterprise was worth, with all of its assets.

4.123 Finally, the United States' example concerning the rich uncle buying a building could be perfectly applicable even if the nephew had bought the building with his own money. It is because the supply has increased and the prices have gone down that there is a new building available to the public, and not because that building was bought by a rich uncle.

3. Conclusions

4.124 Although the ASCM does not expressly address the question of privatization, the United States' interpretation of the Agreement is inconsistent with both its letter and objectives, since the privatization of companies at arm's length and at market value absorbs the benefits previously conferred on that company.

4.125 In order to apply countervailing duties under the ASCM, the investigating authority is required to examine whether there are subsidies, and ultimately, benefits. This examination may take place at the initiation of the investigation or upon making a provisional or final determination, or even thereafter, upon examining whether it is necessary to maintain the duties.

4.126 The United States violated Article 10 of the ASCM by applying countervailing duties without complying with the provisions of the ASCM itself.

4.127 Even if there had been a subsidy, it would have been equivalent to zero, so that the United States violated Article 19.4 of the ASCM by applying a higher duty.

V. INTERIM REVIEW

5.1 On 6 October 1999, the Panel issued its interim report to the parties. On 20 October 1999, the European Communities and the United States requested the Panel to review precise aspects of the interim report, in accordance with Article 15.2 of the DSU. Neither party requested an additional meeting with the Panel.

A. Comments by the European Communities

5.2 The European Communities requested changes to the Panel's description of the European Communities' arguments in paragraphs 6.12, 6.36 and 6.71. We have made certain modifications to paragraphs 6.12, 6.36 and 6.71.

5.3 The European Communities requested replacing the word "effectively" in the penultimate sentence of paragraph 6.57 with the word "therefore". Because we consider the word "effectively" appropriate in this context, we decline to make the modification requested by the European Communities.

5.4 The European Communities requested the addition of certain references to footnote 66, in order to include all references where the parties have discussed the term "deter". In our view, the references we have cited in footnote 66 constitute the clearest statement of the US position on whether countervailing duties should be applied to deter subsidization. Since it is the position of the United States on this matter to which footnote 66 refers, we decline to make the modification requested by the European Communities.

5.5 The European Communities requested the Panel to include the terms "of a developing country Member" in the second sentence of footnote 86. Given the explicit wording of Article 27.13 of the SCM Agreement, we have modified footnote 86 in line with the European Communities' request.

5.6 The European Communities requested the Panel to replace the term "conferred" with the term "bestowed" in the second sentence of paragraph 6.80, to avoid confusion and to bring this sentence in line with the terminology used by the Panel elsewhere in its report. We have modified the second sentence of paragraph 6.80 accordingly.

5.7 With regard to paragraph 8.1, the European Communities requested the Panel to also recommend that the United States bring its treatment of pre-privatization subsidies into conformity with the SCM Agreement. Since our terms of reference are restricted to those measures cited by the European Communities in document WT/DS138/3 and WT/DS138/3/Corr. 1, we decline to make the modification requested by the European Communities.

B. Comments by the United States

5.8 The United States requested the Panel to modify paragraphs 6.24, 6.26, 6.60, 6.61 and 6.62, to reflect the distinction between the USDOC's 27 January 1993 final determination and the USDOC's 12 October 1993 remand determination. We have made certain changes to the aforementioned paragraphs.

5.9 The United States requested a modification in the second sentence of paragraph 6.25, concerning the duration of the allocation period. We have modified the second sentence of paragraph 6.25 accordingly.

5.10 The United States requested a correction concerning the identification of the Attachment referenced in footnote 66. We have corrected that reference.

5.11 The United States asked the Panel to include a fuller description of its argument in footnote 66. We have modified our description of the US argument in footnote 66.

5.12 With regard to paragraph 6.59, the United States requested certain modifications to the Panel's description of the US position regarding the existence of "benefit". The United States considered the Panel's description incomplete and disjointed. We note that the language used by the Panel to summarize the US position on the existence of "benefit" is taken from a US submission (Attachment

2.1), and that the United States would simply have the Panel include an extended description of the US position on the existence of "benefit" taken from the same US submission. Since the United States has not demonstrated that our summary of the US position is inconsistent with the arguments made by the United States before this Panel, we decline to make the changes requested by the United States. Any reader wishing to read a complete description of the US arguments on this matter may consult the original US submission, which is explicitly cross-referenced by the Panel at paragraph 6.59.

5.13 The United States requested the Panel to make technical corrections in footnote 75. We have modified footnote 75 accordingly.

VI. FINDINGS

A. Introduction

6.1 On 22 March 1993, the US Department of Commerce ("USDOC") published a countervailing duty order imposing countervailing duties on imports of leaded bars originating *inter alia* in the United Kingdom ("UK").[36] The USDOC initiated administrative reviews of that order in 1994, 1995, 1996, 1997, 1998 and 1999. This dispute concerns the consistency with Articles 10 and 19.4 of the Agreement on Subsidies and Countervailing Measures ("SCM Agreement") of the countervailing duties imposed as a result of the administrative reviews initiated in 1995, 1996 and 1997.

B. Preliminary Issues

1. Participation of observers

6.2 By letter dated Friday, 11 June 1999, the United States asked the Panel to allow observers to attend the Panel's meetings with the parties. In response, the Panel issued the following decision at the first substantive meeting with the parties:

> **DECISION CONCERNING THE US REQUEST FOR PARTICIPATION BY OBSERVERS**
>
> By letter dated Friday, 11 June 1999, the United States asked the Panel to allow observers to attend the Panel's meetings with the parties. The Panel notes that the US request was submitted only one full working day before the first substantive meeting of the Panel with the parties on Tuesday, 15 June 1999. The Panel regrets that the United States was not able to submit its request in a more timely manner.
>
> By letter dated Monday, 14 June 1999, the Panel sought the views of the EC, Brazil and Mexico on this matter. In separate written re-

[36] 58 Fed. Reg., p. 15327 (hereinafter "1993 *Leaded Bars* duty order").

sponses dated 14 June 1999, the EC, Brazil and Mexico asked the Panel to reject the US request. The Panel is grateful for the speed with which the EC, Brazil and Mexico were able to provide their views on this matter.

We note that, in accordance with paragraph 2 of the Panel Working Procedures contained in Appendix 3 of the DSU ("Appendix 3 Working Procedures"), "[t]he panel shall meet in closed session." Whereas paragraph 2 refers to the presence of the "parties to the dispute" and "interested parties"[37] at panel meetings, paragraph 2 does not refer to the presence of observers. For this reason, we consider that participation by observers at panel meetings would be inconsistent with paragraph 2 of the Appendix 3 Working Procedures.

Article 12.1 of the DSU provides that a panel is entitled to depart from or add to paragraph 2 of the Panel Working Procedures, after consulting the parties to the dispute. In *United States - Import Prohibition of Certain Shrimp and Shrimp Products*, the Appellate Body explained that:

" … Article 12.1 of the DSU authorizes panels to depart from, or add to, the Working Procedures set forth in Appendix 3 of the DSU, and in effect to develop their own Working Procedures, after consultation with the parties."

Article 12.1 of the DSU requires a panel to consult with the parties before developing its own Working Procedures. Article 12.1 does not expressly require a panel to seek the agreement of the parties to the dispute before developing its own Working Procedures. However, in certain circumstances such agreement would appear appropriate. This is especially so with regard to the participation of observers, as a result of possible implications for the confidentiality of parties' oral statements to the panel.

Paragraph 3 of the Appendix 3 Working Procedures provides that "documents submitted to [the panel] shall be kept confidential." Paragraph 3 does not refer to the confidentiality of oral statements made by parties during meetings with the panel. However, to the extent that a party's oral statement refers to, or repeats, all or part of its written submission to the panel, a failure to protect the confidentiality of a party's oral statement could effectively undermine the confidentiality of its written submission.

By virtue of paragraph 3 of the Appendix 3 Working Procedures, a party may forego the confidentiality of its written and oral submissions by "disclosing statements of its own position to the public." We note that it is up to each party to decide whether it wishes to

[37] In our opinion, the term "interested parties" refers to third parties, *i.e.*, "parties which have notified their interest in the dispute to the DSB" (para. 6, Appendix 3 Working Procedures).

> forego the confidentiality of its submissions to the panel. This is not a decision to be made by a panel. Since it is up to each party to decide whether or not it chooses to forego its right to confidentiality for its written and oral submissions to a panel, we are obliged to seek the agreement of each party before implementing Working Procedures that might undermine the confidentiality of a party's written and oral submissions. By its 14 June response to the US request of 11 June 1999, the EC effectively withheld such agreement. As a result, we are not in a position to develop any Working Procedures that might jeopardise the confidentiality of the EC written and oral submissions to the Panel. Accordingly, we are unable to grant the US request to open this meeting to observers.

2. Amicus curiae brief

6.3 On 19 July 1999, we received a brief from the American Iron and Steel Institute ("AISI") dated 13 July 1999. We note that, by virtue of Articles 12 and 13 of the DSU, a panel "has the discretionary authority either to accept and consider or to reject information and advice submitted to it, *whether requested by a panel or not*."[38] While we clearly have the discretionary authority to accept the AISI brief, in this case we chose not to exercise that authority as a result of the late submission of the brief. The AISI brief was submitted after the deadline for the parties' rebuttal submissions, and after the second substantive meeting of the Panel with the parties. Thus, the parties have not, as a practical matter, had adequate opportunity to present their comments on the AISI brief to the Panel. In our view, the inability of the parties to present their comments on the AISI brief raises serious due process concerns as to the extent to which the Panel could consider the brief. In accordance with Article 12.1 of the DSU, the Panel may have been entitled to delay its proceedings in order to provide the parties sufficient opportunity to comment on the AISI brief. However, we considered that any such delay could not be justified in the present case.

3. Request for information

6.4 In its written response to a question from the Panel,[39] the European Communities requested the Panel to "ask the United States to provide all parties with [the] facts [surrounding the Richemont spin-off in *Stainless Steel Sheet and Strip in Coils from France*[40]], including: (1) the essential USDOC spin-off calculation worksheets containing all the specific numbers that led to the conclusions drawn by USDOC regarding the spin-offs in the case, and (2) all supporting memoran-

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[38] *United States - Import Prohibition of Certain Shrimp and Shrimp Products* (hereinafter "*US - Shrimp*"), WT/DS58/AB/R, adopted 6 November 1998, DSR 1998:VII, 2755, para. 108.

[39] See Attachment 1.3, Question 3.

[40] *Stainless Steel Sheet and Strip in Coils from France*, 64 Fed. Reg. 30774, 8 June 1999 (hereinafter "Stainless Steel Sheet and Strip in Coils from France").

dums, including the portion of the verification report dealing with Richemont cited by the USDOC at 64 Fed. Reg. 30776."

6.5 In response to a separate question from the Panel, the United States asserted that such information "was submitted … as business proprietary information, and USDOC is therefore precluded by U.S. law from divulging it."

6.6 We note that, by virtue of Article 13 of the DSU, a panel has authority to seek information and technical advice from "any individual or body" it may consider appropriate, or from "any relevant source." The "comprehensive nature" of this authority was emphasised by the Appellate Body in *United States - Shrimp*.[41] In *Canada - Measures Affecting the Export of Civilian Aircraft*, the Appellate Body explicitly stated that a panel has the authority to seek information from "*any Member*, including *a fortiori* a Member who is a party to a dispute before a panel."[42]

6.7 Thus, if we consider it appropriate, there is no doubt that we have the authority to request information concerning the Richemont spin-off from the United States. In particular, we are not persuaded that the proprietary nature of the information precludes us from requesting (or the United States from submitting) the information, since it is open to the Panel to implement special procedures to protect proprietary information.[43] However, we do not consider it necessary to request the relevant information from the United States. In our view, the present dispute can be resolved without reference to the precise facts surrounding the Richemont spin-off in *Stainless Steel Sheet and Strip*. For this reason, we decline to exercise our authority under Article 13 of the DSU to ask the United States to provide the information sought by the European Communities.

4. Standard of review

(a) The United States

6.8 The United States asserts that the standard of review set forth in Article 17.6 of the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 (hereinafter the "AD Agreement") is expressly made applicable to disputes under the SCM Agreement by virtue of the Ministerial Declaration on Dispute Settlement Pursuant to the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 or Part V of the Agreement on Subsidies and Countervailing Measures (hereinafter "Ministerial Declaration"), which refers to "the need for consistent resolution of disputes arising from anti-dumping and countervailing duty measures." The United States argues that this Ministerial Declaration "must have some meaning". In the United States' view, Members were aware of the many similarities between the anti-dumping proceedings and the countervailing duty proceedings that a

[41] *US - Shrimp*, *supra*, footnote 38, para. 104.

[42] *Canada - Measures Affecting the Export of Civilian Aircraft* (hereinafter "*Canada Aircraft*"), WT/DS70/AB/R, adopted 20 August 1999, DSR 1999:III, 1377, para. 185.

[43] We note that such special procedures were implemented by the *Canada Aircraft* panel (WT/DS70/AB/R, adopted 20 August 1999, Annex 1).

panel would be reviewing, and they did not want inconsistent resolutions for disputes under the AD Agreement and the SCM Agreement simply because of the use of different standards of review. According to the United States, the import of the Ministerial Declaration is that a panel should use the AD Agreement's standard of review when reviewing a countervailing duty proceeding.

6.9 In response to a question from the Panel regarding the Ministerial Decision on Review of Article 17.6 of the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 (hereinafter "Ministerial Decision"), the United States asserts that the Article 17.6 standard of review does not apply to the present dispute by virtue of the "general application" of that provision. Accordingly, the United States argues that the Ministerial Decision is not relevant in this dispute.

6.10 In the event that the Panel finds the standard of review set forth in Article 17.6 of the AD Agreement inapplicable to this dispute, the United States accepts that the Appellate Body's decision in *European Communities - Measures Concerning Meat and Meat Products*[44] states the applicable standard of review, *i.e.*, that set forth in Articles 3.2 and 11 of the DSU. However, the United States asserts that the *Hormones* decision does not represent a complete statement of the standard of review that must be applied by the Panel in this dispute. In particular, with regard to legal questions, the *Hormones* decision explains only that a panel must apply the customary rules of interpretation of public international law. It does not address what a panel should do in the situation where, as in the present case, the agreement at issue is silent with regard to a particular matter even after applying the customary rules of interpretation of public international law. According to the United States, the key provision in the SCM Agreement - Article 1.1 - is silent regarding how an investigating authority is to handle previously bestowed subsidies following a change in the ownership of the subsidized company.

6.11 The United States submits that, when the SCM Agreement is silent, a panel addressing a dispute under Part V of the SCM Agreement should follow either *United States - Imposition of Countervailing Duties on Imports of Fresh and Chilled Atlantic Salmon from Norway*, where the panel stopped its analysis and found the challenged approach to be not inconsistent with the relevant agreement after determining that the agreement was silent,[45] or *New Zealand - Imports of Electrical Transformers from Finland*, where the panel took a slightly different approach and found no violation of the relevant agreement after con-

[44] *European Communities - Measures Concerning Meat and Meat Products (*hereinafter "*EC - Hormones*"*)*, WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998, DSR 1998:I, 135, at para. 114-19.

[45] *United States - Imposition of Countervailing Duties on Imports of Fresh and Chilled Atlantic Salmon from Norway (hereinafter "US – Norwegian Salmon CVD*"), adopted 28 April 1994, BISD 41S/II/576, at paras. 243-46 and 247-49.

cluding that the approach used by the investigating authority "appeared to be a reasonable one."[46]

(b) The European Communities

6.12 The European Communities objects to the application of the standard of review set forth in Article 17.6 of the AD Agreement to the present case. The European Communities asserts that Articles 3.2 and 11 of the DSU set the standard of review applicable in this dispute. The European Communities takes issue with the US interpretation of the Ministerial Declaration, asserting that a "consistent resolution" of disputes does not allow for an "adoption" of Article 17.6 of the AD Agreement in a different Agreement than for which it was written. The European Communities argues first that Ministerial Declaration is not a covered agreement and therefore not within the Panel's mandate; it is more in the nature of a reminder to negotiators to aim for consistency between the Antidumping and Countervailing Duty provisions. In any event, the EC submits that any meaning it has is much more limited , requiring only that parallel provisions in the two Agreements should be dealt with in a consistent way. For example, an allegation that an investigating country had exceeded the maximum 18 months for an investigation should not be treated differently in anti-dumping and countervailing duty cases.[47] The European Communities asserts that taking the far-reaching step of adopting textual provisions into an Agreement which are not there would "add to or diminish the rights and obligations provided in the covered agreements", and would therefore violate Article 3.2 DSU.

6.13 The European Communities submits that there is no ground for ignoring the text of the Ministerial Decision and the United States offers none. The text of the Ministerial Decision is clear, in that it should be decided at a later time whether or not Article 17.6 of the AD Agreement could be capable of "general application". The European Communities believe that the ordinary meaning of the term "general application" is the "use outside the Anti-Dumping Agreement", or the "use in all other covered agreements of the WTO". The text of the Ministerial Decision does not contain any preferential treatment for the SCM Agreement, which would somehow allow the adoption of the 17.6 standard already at this moment in time in the SCM Agreement.

6.14 The European Communities denies that the SCM Agreement is "silent" on the key issues in dispute, since the SCM Agreement is not "silent" on the fundamental obligation of a Member to establish the existence of a "benefit", and therefore a "subsidy" which may be "offset" by countervailing duties, to the company under investigation. The European Communities also argues that there is no room for a reliance on the two pre-WTO cases referred to by the United States, since they concern only technical factual calculations by national authorities in

[46] *New Zealand - Imports of Electrical Transformers from Finland (hereinafter "New Zealand – Finnish Transformers*"), adopted on 18 July 1985, BISD 32/S55, at paras. 4.2-4.3.

[47] Thus, the European Communities asserts for example that disputes regarding Articles 5.10 of the AD Agreement and 11.11 of the SCM Agreement should be resolved in a consistent way.

areas in which the relevant GATT Codes were silent. As such, the European Communities believes that these cases are particularly lacking in relevance in the present case, where a fundamental precept of the SCM Agreement is at issue.

(c) Evaluation by the Panel

6.15 The United States advocates the application of the standard of review set forth in Article 17.6 of the AD Agreement. Given the nature of the present dispute, it is in particular the standard of review set forth in paragraph (ii) of Article 17.6 which the United States would have us apply. Article 17.6 (ii) of the AD Agreement provides:

> "the panel shall interpret the relevant provisions of the Agreement in accordance with customary rules of interpretation of public international law. Where the panel finds that a relevant provision of the Agreement admits of more than one permissible interpretation, the panel shall find the authorities' measure to be in conformity with the Agreement if it rests upon one of those permissible interpretations."

6.16 At the outset, we note that the United States does not rely on the provisions of the SCM Agreement to argue that the standard of review set forth in Article 17.6 of the AD Agreement applies in the present case. We also note that, in light of the Ministerial Decision, the United States does not consider the Article 17.6 standard of review to be of "general application". Rather, the sole basis relied on by the United States for applying the Article 17.6 standard of review is the Ministerial Declaration which, in the opinion of the United States, "must have some meaning".

6.17 We agree that the Ministerial Declaration "must have some meaning". However, it is not immediately apparent from the text of the Ministerial Declaration that it has the meaning attributed to it by the United States.[48] Assuming *arguendo* that it was the intention of the Ministers to introduce the standard of review set forth in Article 17.6 of the AD Agreement into the SCM Agreement (with a view to resolving anti-dumping and countervailing duty disputes in a consistent manner)[49], there is nothing in the Ministerial Declaration to create any obligations in this regard. We note that the Ministerial Declaration is a mere "Declaration", rather than a "Decision" of the Ministers. In our view, a Declaration lacks the mandatory authority of a Decision. In the Ministerial Declaration, Ministers simply "recognize … the need" for the consistent resolution of disputes. In our opinion, the simple recognition of the need for an action does not mandate that action. In a Ministerial Decision, by contrast, Ministers "decide" that certain action shall be taken. For these reasons, we do not consider that the

[48] Indeed, we note that a further meaning has also been attributed to the Ministerial Declaration by the European Communities.

[49] We note that the matter in the present case is essentially concerned with the existence of a subsidy. This, of course, is not a matter that would ever arise in the context of a dispute concerning anti-dumping duties.

Ministerial Declaration imposes any obligations on this Panel. In particular, we do not consider that the Ministerial Declaration requires this Panel to apply the standard of review set forth in Article 17.6 of the AD Agreement.

6.18 We note that, by virtue of Article 30 of the SCM Agreement, the provisions of the DSU are applicable to the settlement of disputes under the SCM Agreement, "except as otherwise specifically provided [t]herein." In the absence of any specific standard of review provided for in the SCM Agreement, we consider that we are subject to the standard of review set forth in Article 11 of the DSU. By virtue of that provision, we are required to "make an objective assessment of the matter before [us], including an objective assessment of … the applicability of and conformity with the [SCM Agreement]". We note that this approach is entirely consistent with statements made by the Appellate Body in *Hormones*.[50] We also note that the United States has in principle accepted the application of the standard of review set forth in Article 11 of the DSU, in the event that we do not apply the standard of review set forth in Article 17.6 of the AD Agreement.

6.19 The United States has argued that the standard of review provided for in Article 11 of the DSU does not apply in cases "where the agreement at issue is silent with regard to a particular matter even after applying the customary rules of interpretation of public international law." In such cases, the United States argues that panels should apply the same standard of review applied by the GATT panels on *United States Salmon* and *New Zealand Electrical Transformers*. We do not consider it necessary to address this argument in any detail, since we disagree with the United States that the SCM Agreement is silent with regard to the particular matter at issue in the present dispute. As explained fully in the next section of our report, we consider Articles 1.1(b), 19.1, 19.4 and 21.1 of the SCM Agreement, and Article VI:3 of the GATT 1994, to be particularly relevant to the matter before us.

C. Were the Countervailing Duties Imposed as a Result of the 1995, 1996 and 1997 Administrative Reviews Consistent with Articles 10 and 19.4 of the SCM Agreement?

6.20 The European Communities claims that the countervailing duties imposed as a result of the administrative reviews initiated in 1995, 1996 and 1997 are inconsistent with Articles 10 and 19.4 of the SCM Agreement because the USDOC failed to take proper account of various changes in ownership concerning the UK leaded bar producers/exporters under review. Since the European Communities' Article 19.4 claim repeats many of the arguments advanced in support of its Arti-

[50] We note in particular that, "[i]n so far as legal questions are concerned - that is, consistency or inconsistency of a Member's measure with the provisions of the applicable agreement - … Article 11 of the DSU is directly on point, requiring a panel to "make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements ..." (*EC - Hormones*, WT/DS26/AB/R, WT/DS48/AB/R, *supra*, footnote 44, para. 118).

cle 10 claim, we consider it appropriate to first address the European Communities' Article 10 claim.

6.21 Before examining the substance of the European Communities' Article 10 claim, we shall first review the principal facts surrounding the three administrative reviews at issue.

1. The Facts

6.22 From 1967 to 1986, the main UK producer/exporter of hot rolled lead and bismuth carbon steel (hereinafter "leaded bars") was British Steel Corporation ("BSC"). BSC was a state-owned enterprise. United Engineering Steels ("UES") was created in 1986, as a joint venture between BSC and privately-owned Guest, Keen and Nettlefolds ("GKN"). Both BSC and GKN provided assets to UES, in return for equal shares in the joint venture. In particular, BSC spun-off its leaded bar-producing assets (known as the "Special Steels Business") to UES. Negotiations concerning this change in ownership, including the extent of BSC's holding in UES, were conducted at arm's length, consistent with commercial considerations. BSC ceased producing leaded bars after the spin-off of its leaded bar-producing assets to UES.

6.23 BSC was privatized in 1988. As a first step, in September 1988 British Steel public limited company ("BSplc") assumed the property, rights and liabilities of BSC, including BSC's holding in UES. In December 1988, shares in BSplc were sold through the stockmarket. The US Department of Commerce ("USDOC") confirmed that the sale of BSplc shares was at arm's length, for fair market value and consistent with commercial considerations. Henceforth, both UES parent companies (BSplc and GKN) were in private hands. On 20 March 1995 BSplc purchased GKN's holding in UES, whereupon UES was renamed British Steel Engineering Steels ("BSES").

6.24 On 8 May 1992, a countervailing duty investigation was initiated by the United States against imports of leaded bars from, *inter alia*, the United Kingdom. The period of investigation was calendar year 1991. On 27 January 1993, the United States Department of Commerce (USDOC) issued its final determination, but later amended this determination on 12 October 1993 pursuant to a court remand (hereinafter collectively "1993 *Leaded Bars* determination").[51] On 22 March 1993, the USDOC published a countervailing duty order imposing countervailing duties on imports of leaded bars originating *inter alia* in the United Kingdom.[52]

[51] *Final Affirmative Countervailing Duty Determination: Certain Hot Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom*, 58 Fed. Reg. 6237, and *Remand Determination of US Department of Commerce on General Issues of Privatization, Certain Hot Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom, 12 October 1993 (unpublished).*

[52] 58 Fed. Reg., p. 15327 (hereinafter "1993 *Leaded Bars* duty order").

6.25 In its 1993 *Leaded Bars* determination, the USDOC found that non-recurring,[53] untied[54] subsidies had been bestowed on BSC prior to 1986. The USDOC allocated these subsidies over 15 years, deemed to be the useful life of productive assets in the steel industry.[55] The period over which the pre-1985/86 subsidies were allocated therefore included the creation of UES (1986), the privatization of BSplc (1988), and BSplc's acquisition of UES (1995).

6.26 The USDOC 1993 *Leaded Bars* determination concerned imports of leaded bars produced by UES. The USDOC found that a portion of the pre-1985/86 subsidies provided to BSC "travelled"[56] to UES, via BSC's Special Steels Business. In doing so, the USDOC first calculated the pro rata portion of pre-1985/86 subsidies to BSC (allocated to the period of investigation of the 1993 *Leaded Bars* determination) that could be attributed to its Special Steels Business. Using its "change-in-ownership" methodology, the USDOC then determined what portion of the pre-1985/86 subsidies attributable pro rata to BSC's Special Steels Business during the period of investigation should "pass through" to UES via BSC's Special Steels Business. Countervailing duties were imposed on imports of leaded bars produced by UES on the basis of the portion of benefit "passing through" from BSC to UES during the period of investigation.

6.27 The USDOC's 1993 *Leaded Bars* duty order was subject to administrative review in 1994, 1995, 1996, 1997, 1998 and 1999. The administrative review initiated in 1994[57] covered part of 1992 and all of 1993 imports of leaded bars produced by UES. The administrative review initiated in 1995[58] covered 1994 imports of leaded bars produced by UES. The USDOC applied the methodology described in the preceding paragraph to calculate the amount of countervailing duties to be imposed on such imports.

6.28 The administrative review initiated in 1996[59] covered imports during the calendar year 1995, the year in which BSplc acquired GKN's interest in UES. For 1995 imports of leaded bars prior to BSplc's March 1995 acquisition of UES (*i.e.*, leaded bars produced by UES), the USDOC applied the same "change-in-

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[53] The parties do not disagree that these subsidies were "non-recurring". The Panel sees no reason to question the classification of the relevant subsidies as "non-recurring", since they were provided on an irregular basis.

[54] The parties do not disagree that these subsidies were "untied". The Panel sees no reason to question the classification of the relevant subsidies as "untied", since they were provided on a company-wide basis, rather than being directed at specific products.

[55] The Panel understands that the USDOC assumed that the "benefit" from non-recurring, untied "financial contributions" bestowed on BSC would "benefit" BSC's future production, because it would be used for investment in productive assets. It is for this reason that the duration of future "benefit" is determined by reference to the useful life of productive assets in the steel industry. The European Communities has not disputed this approach.

[56] *Remand Determination of US Department of Commerce on General Issues of Privatization, Certain Hot Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom, 12 October 1993 (unpublished), page 3.*

[57] *Certain Hot Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom*, 60 Fed. Reg. 44029 (hereinafter "1994 administrative review").

[58] *Certain Hot Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom*, 61 Fed. Reg. 58377 (hereinafter "1995 administrative review").

[59] Ibid., 62 Fed. Reg. 53306 (hereinafter "1996 administrative review").

ownership" methodology as for the 1993 *Leaded Bars* determination, and the 1994 and 1995 administrative reviews.

6.29 For 1995 imports subsequent to BSplc's 20 March 1995 acquisition of UES (*i.e.*, imports of leaded bars produced by BSplc/BSES), the USDOC adopted a two-stage "pass through" approach. First, the USDOC took the benefit of prior BSC subsidies already deemed to have "passed through" to UES (as for pre-20 March 1995 imports), and used its change-in-ownership methodology to allocate that benefit between BSplc (the buyer) and GKN (the seller). Second, the USDOC calculated the benefit "passed through" from BSC to BSplc upon the privatization of BSC.[60] To do so, USDOC calculated all the non-recurring, untied subsidies previously bestowed on BSC, minus those already allocated to UES by virtue of the latter's acquisition of BSC's Special Steels Business assets. This residual category of subsidies to BSC had not been considered by the USDOC before, since BSC had not produced any of the imported leaded bars hitherto taken into account by the USDOC. Using its change-in-ownership methodology, USDOC then allocated a portion of these residual BSC subsidies to BSplc (the buyer of BSC), and a portion to the United Kingdom government (the seller of BSC). Thus, countervailing duties for post-20 March 1995 imports of leaded bars produced by BSplc/BSES were calculated on the basis of (1) "benefit" passing through from UES to BSplc, and (2) "benefit" passing through from BSC to BSplc.

6.30 The administrative review initiated in 1997[61] covered imports during the calendar year 1996. The USDOC adopted the same two-stage approach as in the 1996 administrative review for post-20 March imports of leaded bars produced by BSplc/BSES.

2. The EC Article 10 claim

(a) Arguments of the parties

6.31 We set forth below our understanding of the principal arguments advanced by the parties.

(i) The European Communities

6.32 The European Communities submits that the three administrative reviews at issue are inconsistent with Article 10 of the SCM Agreement, read in conjunction with Articles 19, 1 and 14 of the SCM Agreement, because they impose countervailing duties on the imports of privately-owned companies without first examining or establishing whether there exists any subsidy relating to those imports. According to the European Communities, Article 10 of the SCM Agreement requires that a WTO Member take "all necessary steps" to ensure that

[60] Thus, it is only once BSplc acquires full ownership of UES that the privatization of BSC becomes relevant to the USDOC's findings.

[61] *Certain Hot Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom*, 63 Fed. Reg. 18369 (hereinafter "1997 administrative review").

countervailing duties are imposed by its authorities only in conformity with the terms of the SCM Agreement. The European Communities asserts that Article 10 mandates that a Member make a threshold determination of the "existence" of a subsidy before examining other ASCM requirements. Such a determination must occur prior to and wholly distinct from the later determination of the amount of a subsidy, for which it is a necessary condition precedent.

6.33 The European Communities considers that, consistent with the mandate of Article 10, the fundamental requirement first to determine that a "subsidy exists" is also found elsewhere in the SCM Agreement, including Articles 19.1 and 19.4, and in Article VI of the GATT 1994. Article 19.1 establishes that a Member may impose countervailing duties only after making "a final determination of the existence and amount of a subsidy ...". Article 19.4 ASCM requires that "[n]o countervailing duty shall be levied on any imported product in excess of the amount of the subsidy found to exist ...". Article VI:3 of the GATT 1994 sets forth the same obligation, requiring that "[n]o countervailing duty shall be levied on any product ... in excess of an amount equal to ... the subsidy determined to have been granted. ...".

6.34 Thus, according to the European Communities, the terms of the SCM Agreement require Members to "take all necessary steps" to demonstrate the existence of a subsidy. Consistent with this plain language, this inquiry must occur before a countervailing measure may be imposed. A Member's obligation in this regard cannot and does not end with a determination that an unrelated party at some point in the past received a subsidy. According to the European Communities, it must be demonstrated as a result of all available evidence that the party under investigation, whose goods are the ones subject to an offsetting countervailing duty, was the recipient of a subsidy. This means that it must be demonstrated (not arbitrarily assumed) that the party under investigation has either received itself a financial contribution and a benefit, or has benefited from a financial contribution to a third party. By the clear terms of the Agreement, calculating the amount or allocation of a "subsidy" may not take place without first establishing its existence.

6.35 The European Communities notes that, according to Article 1.1 of the SCM Agreement, a "subsidy" exists if a "financial contribution" by a government or public body confers a "benefit". The European Communities acknowledges that a "financial contribution" was made by the United Kingdom Government to BSC. The European Communities further acknowledges that such financial contributions benefited BSC in the past and constituted "subsidies" to that firm. The European Communities contends, however, that such prior contributions are not "subsidies" in the cases that form the basis for the dispute before this Panel, because they confer no "benefit" on UES or BSplc/BSES, the companies whose products are subject to the relevant US countervailing duty determinations and whose imports into the United States are being assessed for countervailing duties.

6.36 The European Communities submits that, with reference to the context provided by Article 14 of the SCM Agreement, "benefit" must be determined by reference to the market. A "benefit" is only conferred if a "financial contribution" is made available on terms more favourable than those available to the recipient on the market. Accordingly, where a privately-owned company has purchased

productive assets at fair market value in an arm's-length transaction, there can be no benefit conferred on the purchaser within the meaning of the ASCM. A purchaser of formerly state-owned assets at market value is not in any way put in a more advantageous position in comparison to the market.

6.37 The European Communities submits that a "benefit" must be shown to have been conferred on the company whose imports are to be countervailed. According to the European Communities, the record of the *Leaded Bars* determinations before this Panel makes clear that the United States explicitly and repeatedly has refused to enquire as to whether a benefit, and therefore a "subsidy", was conferred on BSplc/BSES or UES, much less to demonstrate that such a "benefit" was actually conferred. Rather, the United States improperly presumed that such a "benefit" was conferred by stating that a previous contribution to BSC "passed through" to UES and BSplc/BSES without demonstrating the "pass through" as an economic reality or explaining the nature of the "pass through" by reference to the SCM Agreement or to any commercial or market benchmark.

6.38 With reference to footnote 36 to Article 10 of the SCM Agreement, and Article VI.3 of the GATT 1994, the European Communities asserts that the object and purpose of countervailing duties is to offset, or neutralise, a subsidy. A Member may not impose countervailing duties to more than offset a subsidy. The European Communities submits that countervailing duties were levied by the United States on UES and, in turn, BSplc/BSES without any demonstration by the United States of the existence of a "subsidy". In doing so, the United States by definition imposed countervailing duties that go beyond "offsetting" any subsidy bestowed directly or indirectly upon the manufacture, production or export of subject merchandise by those companies.

(ii) The United States

6.39 The United States submits that the USDOC administrative reviews at issue were consistent with Article 10 of the SCM Agreement. According to the United States, the SCM Agreement only directs (in Article 1) that the investigating authority identify the existence of a "subsidy," including a subsidy "benefit," as of the time of the subsidy bestowal and (in Article 14) that the investigating authority measure the identified subsidy "benefit" through certain market-rate benchmarks as of the time of the subsidy bestowal.

6.40 In addition, the SCM Agreement contemplates that the measured subsidy "benefit" will be allocated over time, although it does not direct how this allocation must be done. Beyond that, however, the SCM Agreement is silent. It does not address a change in ownership, at least in the context of a countervailing duty proceeding. Specifically, it does not explain whether and, if so, how the investigating authority should take account of a change in ownership taking place after the subsidy bestowal. In fact, the only place where the SCM Agreement addresses changes in ownership is in a provision dealing not with countervailing duty proceedings (under Part V of the SCM Agreement), but rather with WTO subsidy challenges under Part III of the SCM Agreement. That provision, Article 27.13, strongly implies a general rule that previously bestowed subsidies remain actionable and are allocable to the successor company's production following a

change in ownership, which is consistent with USDOC's approach but exactly the opposite of the approach advocated by the EC.

6.41 According to the United States, nothing in Article 1 or Article 14 requires the investigating authority to make a new "benefit" determination, or a new measurement of "benefit", simply because the ownership of the original subsidy recipient/beneficiary has changed hands. The United States submits that the SCM Agreement assumes that subsidies satisfying the requirements of Article 1.1 benefit the merchandise produced as a result of those subsidies, regardless of who owns the company or the productive assets used to produce the merchandise and regardless of who purchases the merchandise. In the case of untied, non-recurring subsidies, the relevant financial contribution is deemed to benefit the activities of the subsidized company over a period of time, known as the "benefit stream". Likewise, the United States submits that, because Article 27.13 of the SCM Agreement contemplates a general rule that previously bestowed subsidies remain actionable and are allocable to the production of the surviving privatized company, Article 27.13 implicitly rejects the contrary notion that a subsidy "benefit" must be re-identified or re-measured as of the time of the change in ownership.

6.42 The United States believes that the European Communities is making a crucial - yet unsupportable - assumption when it argues that the investigating authority is required to make another "benefit" determination when the ownership of the subsidy recipient changes hands, given that the SCM Agreement requires the investigating authority to establish that the firm under investigation was the subsidy recipient before it may impose duties. The European Communities is assuming that when the ownership of the subsidy recipient changes hands, the successor firm is unrelated to, and different from, the subsidy recipient. Plainly, while the owners may be different and unrelated, the productive assets which benefitted from the subsidy before the change in ownership are the same ones used by the new owners after the change in ownership. The United States argues that the determinative factor is the productive assets - not the owners - given that Article VI:3 of the GATT 1994 and Article 10 of the SCM Agreement refer to the "subsidy" as having been "bestowed, directly or indirectly, upon the manufacture, production or export of" the product. In focusing on the productive assets, the United States asserts that the successor firm really is "no different" from the subsidy recipient, and consequently there is no need - even under the European Communities' theory - for a second benefit determination after the change in ownership.

6.43 The United States also strongly disagrees with the European Communities' assertion that it is necessary for the investigating authority to demonstrate that the firm under investigation was the actual recipient of the subsidy before it may impose duties. This assertion in no way follows from the fact that the investigating authority must first identify the existence of a subsidy before measuring and allocating the amount of the subsidy found to exist and imposing a countervailing duty. The simple requirement that the investigating authority begin its analysis by first identifying the existence of a subsidy does not shed any light on the question whether the identified benefit must be the one bestowed originally or whether a *continuing* benefit must be identified with regard to the new owner of the subsidy

recipient.[62] Furthermore, the United States considers it especially significant that the European Communities does not, in its view, rely on the text of the provision that directly governs the identification of the subsidy benefit, i.e., Article 1.1(b), or even the context provided by the measurement provisions of Article 14, when it attempts to support its crucial assertion that it is necessary for the investigating authority to demonstrate that the firm under investigation was the subsidy recipient before it may impose duties. Instead, the only support that the EC offers is what it (erroneously) views as the object and purpose of the SCM Agreement, which, according to the EC, is the imposition of duties to offset the continuing subsidy benefit received by the firm under investigation. The United States concedes that, in the context of the SCM Agreement, there must be, as a practical matter, some entity or individual that receives the Article 1.1 financial contribution. However, this by itself does not mean that the Article 1.1 "benefit" is to that recipient entity or individual. In fact, Article 1.1 itself is silent regarding who or what is the beneficiary of a subsidy. Article VI:3 of GATT 1994 and Article 10 of the SCM Agreement, meanwhile, provide that the purpose of imposing countervailing duties is to offset subsidies bestowed on the manufacture, production or export of the merchandise. In other words, the United States submits that these provisions contemplate that a subsidy benefits the manufacture, production or export of merchandise.

6.44 The United States asserts that the USDOC's change-in-ownership methodology is consistent with the object and purpose of the SCM Agreement, which is to deter and offset trade-distorting government subsidies benefitting merchandise and causing injury to an industry in an importing country. Consistent with this object and purpose, USDOC's methodology helps to remedy the injurious trade distortions that result from government subsidization even after the ownership of the subsidy recipient/beneficiary has changed hands in an arm's length, fair market value transaction. In the United States' view, the European Communities has misstated the object and purpose of the SCM Agreement as being the imposition of duties to offset the continuing subsidy benefit received by the firm under investigation. The United States asserts that the object and purpose of the SCM Agreement is, in fact, to deter and offset trade-distorting government subsidies benefitting merchandise and causing injury to an industry in the importing country. The United States submits that the USDOC imposes countervailing duties in a change-in-ownership situation in order to offset the subsidization found to exist, just as is contemplated by Article 19.4 of the SCM Agreement. The United States does not impose any additional duties in an effort to deter subsidization.

[62] The United States agrees that the investigating authority must first identify the existence of a subsidy, i.e., a "financial contribution" and a "benefit," before measuring and allocating the amount of the subsidy found to exist or imposing a countervailing duty. The United States notes, however, that when the investigating authority uses the benefit-to-recipient measurement standard, the act of identifying the benefit (under Article 1 of the SCM Agreement) is normally the same as measuring the benefit (under Article 14 of the SCM Agreement). The separate act of allocating the identified and measured benefit over time can only be done afterwards.

(b) Evaluation by the Panel

6.45 Article 10 of the SCM Agreement provides in relevant part:

> "Members shall take all necessary steps to ensure that the imposition of a countervailing duty* on any product of the territory of any Member imported into the territory of another Member is in accordance with the provisions of Article VI of GATT 1994 and the terms of this Agreement." (* footnote omitted)

6.46 In applying Article 10 of the SCM Agreement, we recall that Article 3.2 of the DSU requires panels to interpret "covered agreements", including the SCM Agreement, "in accordance with customary rules of interpretation of public international law". The rules of treaty interpretation set forth in Article 31 of the Vienna Convention on the Law of Treaties ("Vienna Convention"), have "attained the status of a rule of customary or general international law".[63] Article 31.1 of the Vienna Convention provides:

> "A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose".

6.47 By virtue of the ordinary meaning of Article 10, a Member is required to "take all necessary steps" to ensure that any countervailing duty it applies is "in accordance with" Article VI of GATT 1994 and the terms of the SCM Agreement. A Member will therefore violate Article 10 if it imposes a countervailing duty that is not "in accordance with" Article VI of GATT 1994 or the terms of the SCM Agreement.

(ii) Conditions for the imposition of countervailing duties

6.48 The European Communities has argued that the United States has violated Article 10 by imposing countervailing duties on imports of leaded bars produced by UES and BSplc/BSES in a manner not in accordance with Article 19 of the SCM Agreement or Article VI:3 of the GATT 1994. According to the European Communities, paragraphs 1 and 4 of Article 19 of the SCM Agreement require the United States to demonstrate the existence of a subsidy in respect of imports of leaded bars produced by UES and BSplc/BSES before imposing countervailing duties on such imports.

6.49 Article 19.1 of the SCM Agreement provides:

> "If, after reasonable efforts have been made to complete consultations, a Member makes a final determination of the existence and amount of the subsidy and that, through the effects of the subsidy, the subsidized imports are causing injury, it may impose a counter-

[63] *United States - Standards for Reformulated and Conventional Gasoline* (hereinafter "*US - Gasoline*"), WT/DS2/AB/R, adopted 20 May 1996, DSR 1996:I, 3, at 16.

> vailing duty in accordance with the provisions of this Article unless the subsidy or subsidies are withdrawn."

6.50 Consistent with the ordinary meaning of Article 19.1, the imposition by a Member of a countervailing duty on an imported product is subject to two conditions. First, the Member must have made a final determination of the existence and amount of a (countervailable)[64] subsidy in respect of the imported products. Second, the Member must have made a final determination that the subsidized imports are causing injury to the relevant domestic industry. Leaving aside the issue of injury, Article 19.1 is therefore clearly based on the premise that no countervailing duties shall be imposed on imported products unless the existence (and amount) of a (countervailable) subsidy is demonstrated in respect of such imports.

6.51 Article 19.4 of the SCM Agreement provides that:

> "No countervailing duty shall be levied* on any imported product in excess of the amount of the subsidy found to exist, calculated in terms of subsidization per unit of the subsidized and exported product." (* footnote omitted)

6.52 By virtue of the ordinary meaning of the text of Article 19.4 of the SCM Agreement, any countervailing duty imposed on an imported product shall not exceed the amount of subsidy found to exist in respect of the imported product. Logically, and consistent with the ordinary meaning of Article 19.4, no countervailing duty may be imposed on an imported product if no (countervailable) subsidy is found to exist with respect to that imported product, since in such cases the amount of subsidy found to exist with respect to the imported product would be zero. Thus, like Article 19.1, Article 19.4 of the SCM Agreement establishes a clear nexus between the imposition of a countervailing duty, and the existence of a (countervailable) subsidy.

6.53 The same nexus between the imposition of a countervailing duty and the existence of a (countervailable) subsidy underlies Article VI:3 of the GATT 1994, which provides in relevant part:

> "No countervailing duty shall be levied on any product of the territory of any contracting party imported into the territory of another contracting party in excess of the amount equal to the estimated bounty or subsidy determined to have been granted, directly or indirectly, on the manufacture, production or export of such product in the country of origin or exportation, including any special subsidy to the transportation of a particular period."

6.54 We believe that at least one other provision of the SCM Agreement is equally relevant in the present context, since it is also based on the premise that no countervailing duties shall be imposed absent (countervailable) subsidization. That provision is Article 21.1, which provides that:

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[64] A subsidy is "countervailable" when it is (1) specific within the meaning of Article 2 of the SCM Agreement, and (2) not non-actionable by virtue of Part IV of the SCM Agreement.

> "A countervailing duty shall remain in force only as long as and to the extent necessary to counteract subsidization which is causing injury."

6.55 By virtue of Article 21.1, countervailing duties may only remain in force so long as there is (1) (countervailable) subsidization, and (2) injury caused by such subsidization. Thus, Article 21.1 establishes a clear link between the (continued) imposition of countervailing duties and the (continued) existence of (countervailable) subsidization.

6.56 In our view, the above provisions are all based on the premise that no countervailing duty may be imposed absent (countervailable) subsidization. Furthermore, we consider that this premise underlies the very purpose of the countervailing measures envisaged by Part V of the SCM Agreement. Footnote 36 to Article 10 of the SCM Agreement provides that "[t]he term 'countervailing duty' shall be understood to mean a special duty levied **for the purpose of offsetting any subsidy** bestowed directly or indirectly upon the manufacture, production or export of any merchandise, as provided for in paragraph 3 of Article VI of GATT 1994" (emphasis supplied). Thus, the imposition of a countervailing duty is only envisaged in circumstances where it is necessary to "offset" a (countervailable) subsidy. In our view, footnote 36 to Article 10 does not envisage the imposition of countervailing duties when no (countervailable) subsidy is found to exist, for in such cases there would be no (countervailable) subsidy to "offset". We note that the parties agree with our understanding of the object and purpose of the countervailing measures envisaged by Part V of the SCM Agreement. The European Communities has stated that "the established purpose for assessment of countervailing duties is to offset the advantage afforded imported merchandise by a subsidy bestowed upon the manufacture, production or export of that merchandise."[65] Despite a different understanding of the object and purpose of the SCM Agreement more generally, the United States has confirmed that the "USDOC imposes countervailing duties in a change-in-ownership situation in order to *offset* the subsidization found to exist, just as is contemplated by Article 19.4 of the SCM Agreement."[66]

6.57 Thus, consistent with the fundamental premise underlying Articles 19.1, 19.4, and 21.1 of the SCM Agreement, and Article VI:3 of the GATT 1994, and consistent with the object and purpose of countervailing duties envisaged by Part V of the SCM Agreement, we consider that a countervailing duty may only be imposed on an imported product if it is demonstrated that a (countervailable)

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[65] See Attachment 1.1, para. 95.

[66] See Attachment 2.6, para. 80. Initially, the United States was understood by the European Communities to argue that countervailing duties were intended to deter subsidization. At the aforementioned para. of the aforementioned submission, the United States clarified that this was not the case: "[t]he United States does not impose any additional duties in an effort to *deter* subsidization. That being said, the United States remains of the view that the mere existence of the disciplines found in the SCM Agreement inherently deters governments from subsidizing, and deterrence is indeed one of the purposes of the SCM Agreement." Without taking any position on the alleged deterrent effect of the existence of the disciplines found in the SCM Agreement, we agree with the United States that countervailing duties should not be imposed in order to deter subsidization.

subsidy was bestowed directly or indirectly on the manufacture, production or export[67] of that merchandise.[68] Since the United States imposed countervailing duties on 1994, 1995 and 1996 imports of leaded bars, we consider that, in light of the fundamental premise underlying Articles 19.1, 19.4, and 21.1 of the SCM Agreement, Article VI:3 of the GATT 1994, and the object and purpose of countervailing duties, the United States was effectively required, by virtue of Article 10, to demonstrate that a (countervailable) subsidy was bestowed directly or indirectly on the production of those imports. In order to determine whether the United States satisfied this requirement, it is necessary to examine the criteria for determining the existence of a "subsidy".

(iii) The existence of "benefit"

6.58 The criteria for determining the existence of a subsidy are set forth in Article 1 of the SCM Agreement. In short, Article 1.1 of the SCM Agreement provides that a subsidy exists if a "financial contribution" by a government or public body confers a "benefit". In challenging the USDOC findings that subsidies were bestowed on the production of leaded bars produced by UES and BSplc, the European Communities asserts that the "financial contributions" to BSC did not confer any "benefit" on UES or BSplc. It is the alleged absence of any finding of "benefit" to UES or BSplc which forms the basis for the European Communities' Article 10 claim.[69]

6.59 With regard to the existence of "benefit", the United States has informed us that:

> "the U.S. countervailing duty statute contains 'the irrebuttable presumption that nonrecurring subsidies benefit merchandise produced by the recipient over time,' without requiring any re-evaluation of those subsidies based on the use or effect of those subsidies or subsequent events in the marketplace.
>
> The 'irrebuttable presumption' concept, as used in this context, is simply a reference to USDOC's normal allocation methodology. Under that methodology, which applies to so-called 'non-recurring'

[67] As the present case concerns alleged production subsidies, we shall give no further consideration to the potential existence of subsidies bestowed directly or indirectly on manufacture or export.

[68] The United States appears to accept the premise that a countervailing duty may only be imposed if there is subsidization. In its first submission, the United States asserted that the USDOC "is authorized to impose duties on the showing that two statutory requirements are satisfied: "(1) **a subsidy is provided with respect to the manufacture, production, or sale of a class or kind of merchandise**; and (2) a domestic industry is injured by reason of imports into the United States of that class or kind of merchandise." (See Attachment 2.1, para. 58 (emphasis supplied).

[69] The European Communities is not disputing the existence of relevant "financial contributions". We agree fully with the European Communities in this regard, since a "financial contribution" does not have to be bestowed directly on a company in order to confer a "benefit" on that company. For example, one company may be found to "benefit" from a "financial contribution" conferred on another company. Furthermore, in certain circumstances an untied, non-recurring "financial contribution" bestowed directly on, and benefiting, a prior company may be deemed to have been bestowed indirectly on the successor company.

> subsidies, (footnote omitted) USDOC allocates the measured subsidy benefit over time, i.e., to future production, pursuant to a standard declining balance formula that generates a net present value equal to the amount of the subsidy. The period of time selected for this allocation is based on the subsidy recipient's average useful life of assets. … On the basis of these principles, USDOC affirmatively adopted the approach of treating non-recurring subsidies previously provided to the seller as potentially allocable to the production transferred to the purchaser in a privatization or other change-in-ownership transaction, such as when a government-owned company sells one of its productive units."[70]

6.60 This approach was explained further by the USDOC in its 1993 *Leaded Bars* determination, where the USDOC examined whether "potentially allocable subsidies … could have travelled with the productive unit" following a change in ownership.[71]

6.61 In its 1993 *Leaded Bars* determination, the USDOC "calculate[d] the benefit from prior subsidies which passed through from BSC to UES"[72] when UES acquired BSC's Special Steels Business, the latter considered by the USDOC to be a "productive unit." The USDOC explained that "[w]hen a productive unit is sold by a company which continues to operate (such as BSC), the potentially allocable subsidies which could have travelled with the productive unit, but did not because they were accounted for as part of the purchase price, simply stay with the selling company. As such, they have not been extinguished. Instead, they continue to benefit the seller and our calculation represents the allocation of the subsidies between the seller and the productive unit it has sold." As a result, the USDOC imposed countervailing duties on imports of leaded bars produced by UES, based on that portion of "benefit" from prior subsidies that was deemed by the USDOC to have passed through to UES. With regard to the existence of "benefit" in particular, we understand the USDOC to have found that "benefit" conferred on BSC by pre-1985/86 "financial contributions" to BSC passed through in part to UES. This understanding is confirmed by the USDOC in its 1995 administrative review of its 1993 *Leaded Bars* duty order, in which it stated that "when UES was formed, a portion of the pre-1985/86 subsidies provided to BSC continued to benefit the production of UES."[36]

6.62 In its 1995 administrative review, the USDOC "found that UES continues to benefit from subsidies received by BSC",[73] and continued to impose counter-

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[70] See Attachment 2.1, paras. 43, 44 and 46.

[71] *Remand Determination of US Department of Commerce on General Issues of Privatization, Certain Hot Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom, 12 October 1993 (unpublished), page 5.* We note that at page 6240 of its 27 January 1993 determination, the USDOC stated that "as [a subsidized] company disposes of its productive entities, these entities take a portion of the [subsidy] benefits with them when they 'travel to their new home'."

[72] Ibid.*, page 2.*

[73] *Remand Determination of US Department of Commerce on General Issues of Privatization, Certain Hot Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom, 12 October 1993 (unpublished), page 2.*

vailing duties on 1994 imports of leaded bars produced by UES. The USDOC effectively made the same finding of "benefit" with respect to UES in its 1996 administrative review, and therefore continued to impose countervailing duties on 1995 imports of leaded bars produced by UES. In its 1996 administrative review, the USDOC also found that a portion of pre-1985/86 subsidies bestowed on BSC "travel[led]" to BSplc/BSES.[74] Again, with regard to the existence of "benefit" in particular, we understand the USDOC to have found that the "benefit" conferred on BSC by pre-1985/86 "financial contributions" to BSC passed through to BSplc/BSES. As a result, the USDOC imposed countervailing duties on 1995 imports of leaded bars produced by BSplc/BSES. The USDOC effectively made the same finding of "benefit" with respect to BSplc/BSES in its 1997 administrative review, and continued to impose countervailing duties on 1996 imports of leaded bars produced by BSplc/BSES.[75]

6.63 Are the USDOC's findings on "benefit" sufficient to determine that subsidies were bestowed on the production by UES and BSplc/BSES respectively of leaded bars imported into the United States in 1994, 1995 and 1996? In our view, a proper interpretation of the term "benefit" provides the key for resolving this issue.

6.64 The term "benefit" was recently interpreted by the *Canada Aircraft* panel. That panel found that:

> " … the ordinary meaning of "benefit" clearly encompasses some form of advantage. … In order to determine whether a financial contribution (in the sense of Article 1.1(a)(i)) confers a "benefit", *i.e.*, an advantage, it is necessary to determine whether the financial contribution places the recipient in a more advantageous position than would have been the case but for the financial contribution. In our view, the only logical basis for determining the position the recipient would have been in absent the financial contribution is the market. Accordingly, a financial contribution will only confer a "benefit", i.e., an advantage, if it is provided on terms that are more advantageous than those that would have been available to the recipient on the market."[76]

6.65 The *Canada Aircraft* panel's interpretation of "benefit" was upheld by the Appellate Body. The Appellate Body stated that:

> "A 'benefit' does not exist in the abstract, but must be received and enjoyed by a beneficiary or a recipient. Logically, a "benefit" can be said to arise only if a person, natural or legal, or a group of persons, has in fact received something. The term 'benefit', therefore, implies that there must be a recipient."

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[74] 1996 administrative review, at p. 53308.

[75] We note that the USDOC recently completed its 1998 administrative review of the 1993 *Leaded Bars* duty order (64 Fed. Reg., Number 154). The 1999 administrative review of the 1993 *Leaded Bars* duty order was initiated on 30 April 1999 (64 Fed. Reg., at p. 23269).

[76] *Canada - Aircraft*, WT/DS70/R, adopted 20 August 1999, as upheld by the Appellate Body Report, WT/DS70/AB/R, DSR 1999:IV, 1443, para. 9.112.

> "We also believe that the word 'benefit', as used in Article 1.1(b), implies some kind of comparison. This must be so, for there can be no 'benefit' to the recipient unless the 'financial contribution' makes the recipient 'better off' than it would otherwise have been, absent that contribution. In our view, the marketplace provides an appropriate basis for comparison in determining whether a 'benefit' has been 'conferred', because the trade-distorting potential of a 'financial contribution' can be identified by determining whether the recipient has received a 'financial contribution' on terms more favourable than those available to the recipient in the market."[77]

6.66 We agree with the approach of the panel and the Appellate Body in *Canada Aircraft*.[78] In our view, the existence or non-existence of "benefit" rests on whether the potential recipient or beneficiary, which "logically" must be a legal or natural person, or group of persons, has received a 'financial contribution' on terms more favourable than those available to the potential recipient or beneficiary in the market. Moreover, in the particular context of countervailing duties, we believe that consideration should also be given to Article VI:3 of the GATT 1994, and footnote 36 to Article 10 of the SCM Agreement.

6.67 Article VI:3 of the GATT 1994 provides in relevant part:

> "The term 'countervailing duty' shall be understood to mean a special duty levied for the purpose of offsetting any bounty or subsidy bestowed, directly, or indirectly, upon the manufacture, production or export of any merchandise."

6.68 Footnote 36 to Article 10 of the SCM Agreement provides that:

> "The term 'countervailing duty' shall be understood to mean a special duty levied for the purpose of offsetting any subsidy bestowed directly or indirectly upon the manufacture, production or export of any merchandise, as provided for in paragraph 3 of Article VI of GATT 1994."

6.69 These provisions state that countervailing duties levied on imported products are intended to offset (countervailable) subsidies found to have been bestowed on *inter alia* the production of such imported products. The notion of "subsidy" comprises two elements: (1) "financial contribution, and (2) "benefit". As noted above, "benefit" is determined by reference to the terms on which a "financial contribution" would have been made available to a particular legal or natural person, or group of persons, in the market. Full consideration of Article VI:3 of the GATT 1994 and footnote 36 to Article 10 of the SCM Agreement leads us to conclude that, in the context of countervailing duty investigations, the existence of a "benefit" should be determined by reference to the market terms on

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[77] *Canada - Aircraft, supra*, footnote 42, paras. 154 and 157.

[78] We recall that, while adopted panel reports are not binding on subsequent panels, they do create "legitimate expectations among WTO Members, and therefore, should be taken into account where they are relevant to any dispute" (*Japan - Alcoholic Beverages II, supra*, footnote 42). We consider the same to be true of adopted Appellate Body reports.

which a "financial contribution" bestowed directly or indirectly upon the production of any merchandise would have been made available to the producer of that merchandise. Thus, in order to determine whether any subsidy was bestowed on the production by UES and BSplc/BSES respectively of leaded bars imported into the United States in 1994, 1995 and 1996, it is necessary to determine whether there was any "benefit" to UES and BSplc respectively (*i.e.*, the producers of the imported leaded bars at issue).

6.70 We recall the US argument that the USDOC was not required to find "benefit" to UES and BSplc/BSES specifically, because BSC, UES and BSplc/BSES are not "different companies", since the operations of UES and BSplc are "essentially the same as"[79] the operations of BSC. We, however, are in no doubt that, for the purpose of determining "benefit", a clear distinction should be drawn between BSC, and UES and BSplc/BSES respectively. This is because the changes in ownership leading to the creation of UES and BSplc/BSES involved the payment of consideration for the productive assets etc. acquired by those entities from BSC. Since the finding of "benefit" to BSC was effectively based on BSC acquiring those productive assets etc. for free,[80] the fact that consideration is provided for those productive assets etc. by UES and BSplc/BSES, or the owners thereof, must raise the possibility that the original "benefit" determination in respect of BSC is no longer valid[81] for UES and BSplc/BSES respectively. For this reason, we consider that the changes in ownership leading to the creation of UES and BSplc/BSES should have caused the USDOC to examine whether the production of leaded bars by UES and BSplc/BSES respectively, and not BSC, was subsidized. In particular, the USDOC should have examined the continued existence of "benefit" already deemed to have been conferred by the pre-1985/86 "financial contributions" to BSC, and it should have done so from the perspective of UES and BSplc/BSES respectively, and not BSC.

6.71 The United States has argued that there is no need to determine "benefit" in respect of successor companies, because there is an "irrebuttable presumption" that "benefit" continues to flow from untied, non-recurring "financial contributions", even after changes in ownership. The European Communities has argued that any such presumption can never be "irrebuttable". We agree with the European Communities in this regard. We consider that the presumption of "benefit" flowing from untied, non-recurring "financial contributions" is rebutted in the circumstances surrounding the changes in ownership leading to the creation of

[79] See Attachment 2.8, para. 3.

[80] The term "benefit" effectively represents the portion of a "financial contribution" that, by reference to a market benchmark, the recipient gets for "free". This is the portion of a "financial contribution" that, by reference to a market benchmark, the recipient has not "paid for". In the case of "benefit" conferred by untied, non-recurring "financial contributions", the United States presumes that such "benefit" is used to benefit future production through investment in productive assets. In this sense, the beneficiary of untied, non-recurring "financial contributions" is deemed to have acquired productive assets for "free". The European Communities has not disputed this approach in respect of "benefit" to BSC.

[81] The original "benefit" determination may not remain valid either because there is no longer any "benefit" conferred on the successor company, or because the amount of "benefit" conferred on the successor company is less than that conferred on the prior company.

UES and BSplc/BSES respectively. In such circumstances, the continued existence of "benefit" to UES and BSplc/BSES respectively must be demonstrated.

6.72 This conclusion, which is founded on a proper interpretation of Article 1.1(b) of the ASCM, is necessarily at odds with the US argument that Article 1.1(b) of the ASCM only requires "benefit" to be established once, as of the time of bestowal of the "financial contribution". The United States based that argument on the fact that Article 1.1 describes the relevant "financial contribution" and "benefit" in the present tense. According to the United States, "the ordinary meaning arising from the use of the present tense to describe both elements is that Article 1.1 is concerned with, and requires the identification of, the 'benefit' that is conferred at the time that the government provides the 'financial contribution'". The United States supports its interpretation of Article 1.1. by reference to the four examples of "financial contributions" contained in Article 14. According to the United States, "[if] there is a general rule that can be derived from the text of Article 14, it is that the investigating authority should look to the time of the subsidy bestowal for the measurement of the subsidy benefit". On the basis of these interpretations of Articles 1.1 and 14, the United States concludes that "the SCM Agreement assumes that subsidies satisfying the requirements of Article 1.1 benefit the merchandise produced as a result of those subsidies, regardless of who owns the company or the productive assets used to produce the merchandise and regardless of who purchases the merchandise".[82]

6.73 We are not convinced by the US interpretation of the use of the present tense in Article 1.1 of the SCM Agreement. In our view, the use of the present tense simply means that the requisite "financial contribution" and "benefit" must exist during the relevant period of investigation or review. The use of the present tense does not speak to the issue of whether or not the existence of "benefit" should be determined at the time of bestowal of the "financial contribution", or whether or not there is any need for any subsequent review of the original determination of "financial contribution" and / or "benefit".[83] It simply means that when an investigation or review takes place, the investigating authority must establish the existence of a "financial contribution" and "benefit" during the relevant period of investigation or review. Only then will that investigating authority be able to conclude, to the satisfaction of Article 1.1 (and Article 21), that there **is** a "financial contribution", and that a "benefit" **is** thereby conferred.

6.74 In respect of Article 14 of the SCM Agreement, the United States asserts that "benefit" should be determined by reference to the market practice prevailing **at the time that** each of the four types of "financial contribution" identified in that provision is bestowed. We do not share the United States' temporal interpretation of Article 14. Certainly, this interpretation is not consistent with the ordinary meaning of the text of that provision. Nothing in the text of Article 14 restricts the analysis envisaged in sub-paragraphs (a) - (d) of that provision to the time at which the relevant "financial contribution" was bestowed. In our view,

[82] See Attachment 2.1, para. 133.

[83] The need for a review is determined by provisions such as Article 21.1, 21.2 and 21.3 of the SCM Agreement.

Article 14 simply does what it says it does: it provides guidelines to be respected by Members whenever they calculate "benefit". Those guidelines apply whether "benefit" is calculated at the time of bestowal, or at some subsequent time. Article 14 does not, therefore, guide Members as to when that calculation of "benefit" should take place.

6.75 The United States has also relied heavily on Article 27.13 of the SCM Agreement to reject the notion that a subsidy "benefit" must be re-identified or re-measured at some time subsequent to the initial bestowal of the relevant "financial contribution". The basis for the US argument is that Article 27.13 "contemplates a general rule that previously bestowed subsidies remain actionable and are allocable to the production of the surviving privatized company".[84]

6.76 We note that the scope of Article 27.13 is restricted to the application of Part III of the SCM Agreement vis-à-vis certain subsidies "granted within and directly linked to a privatization programme of a developing country Member". Given that the scope of Article 27.13 is construed in such narrow terms, we hesitate before relying on that provision as context to draw conclusions regarding the conferral of "benefit" by "financial contributions"[85] that, as in this case, were manifestly not "granted within and directly linked to" privatization programmes of a developing Member.[86] We are particularly hesitant given that the conclusion we are asked to draw - namely that there is no requirement under Part V of the SCM Agreement for "benefit" to be re-identified or re-measured at some time subsequent to the initial bestowal of the "financial contribution" - is contrary to what we consider to be the proper interpretation of the term "benefit". In any event, we note that our interpretation of "benefit" would not necessarily render pre-change in ownership "financial contributions" non-actionable: it simply means that, with regard to certain changes in ownership, pre-change in ownership "financial contributions" will only remain actionable if a valid, post-change in ownership, "benefit" determination has been made.[87]

6.77 In order to further explain why it was not necessary for the USDOC to revisit its original "benefit" determination, the United States argued that a determination of "benefit" is not specific to a particular legal or natural person, so that there was therefore no obligation on the USDOC to find "benefit" to UES and BSplc/BSES specifically. According to the United States, "in the context of the SCM Agreement, there must be, as a practical matter, some entity or individual that receives the Article 1.1 financial contribution. However, this by itself does

[84] See Attachment 2.1, para. 156.

[85] We also agree with the European Communities that Article 27.13 pre-supposes the existence of a "subsidy", and would therefore provide little guidance in the context of determining whether or not a "subsidy" or, more particularly, a "benefit", actually exists.

[86] The United States asks the Panel to conclude that Article 27.13 refers to pre-privatization subsidies (See Attachment 2.5, para. 61). To the extent that a pre-privatization subsidy is "granted within and directly linked to" a privatization programme of a developing country Member, we would agree with the United States. However, consistent with the ordinary meaning of the text of Article 27.13, pre-privatization subsidies that are not "granted within and directly linked to" a privatization programme, such as in this case, would clearly fall outside the scope of that provision.

[87] See para. 6.81 below.

not mean that the Article 1.1 "benefit" is to that recipient entity or individual. In fact, Article 1.1 itself is silent regarding who or what is the beneficiary of a subsidy. Article VI:3 of GATT 1994 and Article 10 of the SCM Agreement … provide that the purpose of imposing countervailing duties is to offset subsidies bestowed on the manufacture, production or export of the merchandise. In other words, these provisions contemplate that a subsidy benefits the manufacture, production or export of merchandise."[88]

6.78 In light of our interpretation of the term "benefit", and with reference to the statement by the Appellate Body that "[a] 'benefit' does not exist in the abstract, but must be received and enjoyed by a beneficiary or a recipient", we disagree that "benefit" is conferred on the manufacture, production or export of merchandise, irrespective and without consideration of the person(s) manufacturing, producing, or exporting, the product. In particular, we disagree with the US assertion that "Article 1.1 itself is silent regarding who or what is the beneficiary of a subsidy."[89] In our view, the US approach to determining "benefit" would be abstract in the extreme, since it is impossible to determine whether any "financial contribution" bestowed on manufacture, production or export *per se* is or was made on terms more favourable than those which manufacture, production or export *per se* could have obtained in the market.[90]

6.79 Thus, we are not convinced by the US arguments that, following the relevant changes in ownership, it was not incumbent on the USDOC to demonstrate the continued existence of "benefit" from the perspective of UES and BSplc/BSES, subsequent to the time of bestowal of the relevant "financial contributions".

(iv) "Benefit" to UES and BSplc/BSES

6.80 Consistent with the proper interpretation of the term "benefit", any finding of "benefit" to UES or BSplc/BSES, the producers at issue, must be based on market criteria. In particular, it is necessary to determine whether any "financial contribution" was bestowed on UES or BSplc/BSES on terms more favourable than UES or BSplc/BSES respectively could have obtained in the market.

6.81 We recall that BSC's leaded bar assets were spun-off to UES in 1986. The USDOC found that the transaction "represented an arm's length transaction in which BSC acted consistently with commercial considerations".[91] The United States has not denied that the BSC spin-off was negotiated for fair market value. Furthermore, we recall that BSplc was fully privatized in December 1988. The

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[88] See Attachment 2.8, para. 43.

[89] See Attachment 2.8, para. 43.

[90] In the case of equity infusions, for example, the existence of "benefit" is normally determined by reference to the equityworthiness of the firm into which the capital is injected. A "benefit" will be conferred if that firm is not equityworthy. A similar approach would not be possible if "benefit" were determined from the perspective of the firm's manufacture, production, or export *per se*, since it would obviously be impossible to determine the equityworthiness of the firm's manufacture, production, or export, *per se*.

[91] 1993 *Leaded Bars* determination, at p. 6244.

USDOC found that the privatization of BSplc "was at arm's length, for fair market value and consistent with commercial considerations."[92] Thus, fair market value was paid for all productive assets, goodwill etc. employed by UES and BSplc/BSES in the production of leaded bars imported into the United States in 1994, 1995 and 1996. In these circumstances, we fail to see how pre-1985/86 "financial contributions" bestowed on BSC could subsequently be considered to confer a "benefit" on UES and BSplc/BSES during the relevant periods of review.[93] This does not mean that the pre-1985/86 "financial contributions" bestowed on BSC are necessarily irrelevant for the purpose of determining subsidization of the production of leaded bars by UES and BSplc/BSES. As noted above,[94] we consider that an untied, non-recurring "financial contribution" bestowed on a prior company may constitute a "financial contribution" bestowed indirectly on a successor company. This is because the untied, non-recurring "financial contribution" will be deemed to have been invested in the productive assets etc. of that company. Thus, when those productive assets etc. are acquired by the successor company, the successor company indirectly acquires the "financial contribution" embodied in those productive assets etc. Assuming "financial contributions" bestowed directly on BSC could be deemed to have been bestowed indirectly on UES and BSplc/BSES, this fact alone would not mean that pre-1985/86, untied, non-recurring "financial contributions" bestowed on BSC necessarily confer any "benefit" on UES or BSplc/BSES. This would only be the case if those "financial contributions" were found to have been bestowed indirectly (*i.e.*, through the relevant change-in-ownership transactions) on UES and BSplc/BSES respectively on terms more favourable than UES and BSplc/BSES respectively could have obtained in the market. We consider that such a finding would only be possible if fair market value was not paid for all productive assets etc. acquired by UES and BSplc/BSES respectively from BSC. Since fair market value was paid for all such productive assets etc., we do not consider that any untied, non-recurring "financial contribution" bestowed indirectly on UES and BSplc/BSES could be deemed to confer a "benefit" on those entities.[95]

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[92] *Remand Determination of US Department of Commerce on General Issues of Privatization, Certain Hot Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom, 12 October 1993 (unpublished).*

[93] In *Stainless Steel Sheet and Strip in Coils from France*, the USDOC investigated whether the sale of assets to a government constituted a countervailable subsidy. The USDOC "found no evidence to indicate that the transaction was anything other than an arms-length (*sic*) transaction for full market value. Accordingly, [the USDOC] determine[d] that this program does not constitute a countervailable subsidy …" Although the investigation of that transaction did not concern the application of the USDOC's change-in-ownership methodology, we nevertheless find it instructive that the USDOC found that the sale of assets did not constitute a subsidy precisely because the sale was an arm's length transaction for full market value.

[94] See note 69 above.

[95] We note the US reference to "injurious trade distortions that result from government subsidization even after the ownership of the subsidy recipient/beneficiary has changed hands in an arm's length, fair market value transaction" (See Attachment 2.1, para. 150). We do not need to take any position on whether or not any such "injurious trade distortions" persist after a fair market value change-in-ownership negotiated at arm's length, since the existence of "injurious trade distortions" is not relevant to a proper determination of the existence of "benefit" within the meaning of Article

6.82 In our view, it is irrelevant that the aforementioned fair market value was paid by the (new) owners of UES and BSplc/BSES respectively, rather than those companies themselves. Any approach requiring that fair market value be paid by the company itself, rather than its owners, would elevate form over substance. In the context of privatizations negotiated at arm's length, for fair market value, and consistent with commercial principles, the distinction between a company and its owners is redundant for the purpose of establishing "benefit". Following privatization at arm's length, for fair market value, and consistent with commercial principles, the owners of the privatized company will be profit-maximizers, set on obtaining a market return on the entirety of their investment in the privatized company. Ultimately, therefore, the owners' investment in the privatized company will be recouped through the privatized company providing its owners a market return on the full amount of their investment. In such circumstances, it would be misleading in the extreme to suggest that the price paid by the owners of the privatized company is not ultimately paid by the privatized company itself.

6.83 We note that the USDOC adopted a similar approach to the distinction between a company and its owners in the context of privatization. In 1993, certain petitioners argued before the USDOC that a subsidy should only be considered repaid in the context of privatization if the monies paid to the government - in the form of the purchase price paid for the privatized company - came from that company's own funds, and not those of the new owners of that company. The USDOC rejected that argument in the following terms:

> "Merely because a company has been incorporated to protect its owners from the company's legal liabilities or for beneficial tax and accounting purposes (or both), it does not follow that the financial condition of the owners is irrelevant to the financial position of the firm. The form in which new owners purchase the government company creates no appreciable difference in how that company will be operated overall. The fact that the owners are shareholders and raise capital to purchase the government-owned company through new share issuings, rather than the company itself taking on debt, does not mean that the owners can be indifferent to the profit margin the company generates, as petitioners assert.
>
> Rather, in the real-world marketplace, the owner-shareholders' expectations of a return on their investment cannot be separated from the profitability of the newly privatized company. Privatized companies (and their assets) are now owned and controlled by private parties who are profit-maximizers. Unlike the former company, which did not need to earn a return on capital when owned and controlled by the government (i.e., when the government is 100 percent owner there is no necessity of paying dividends to itself), the privatized firm now faces the same capital market as its com-

1.1(b) of the SCM Agreement. The existence of "benefit" is determined simply by reference to the terms on which a "financial contribution" could be obtained by the recipient on the market.

> petitors. … Put another way, the privatized company now has an obligation to provide to its private owners a market return on the company's full value. The owners will seek to extract a rate of return from their company at least equal to that of alternative investments of similar risk. There is, then, no appreciable difference, as reflected in the marketplace, between the profit-making ability of the company and the owners' realization of a profitable return on their investment in that firm.
>
> To adopt the petitioners' rationale that only a full repayment by the new company can extinguish past subsidies would create a test that would elevate form over substance and produce incentives for foreign governments merely to alter the form of the privatization to satisfy this artificial distinction. If the Department were to ratify such a test, owners could simply lend the company the money to repay at least some portion of the past subsidies, taking the capital out as loan payments, rather than dividends. … Therefore, a private party purchasing all or part of a government- owned company (e.g., a productive unit) can repay prior subsidies on behalf of the company as part or all of the sales price. Therefore, to the extent that a portion of the price paid for a privatized company can reasonably be attributed to prior subsidies, that portion of those subsidies will be extinguished."[96]

6.84 In commenting on the above statements by the USDOC, the United States has not offered any reason why a similar approach to the "non-distinction" between a company and its owners should not be taken in the present case. Whereas the United States indicated that "there are still other contexts where the distinction [between a company and its owners] is relevant", in doing so it only referred to the treatment of tax credits on dividends (which were apparently found by the USDOC to "benefit owners but not the company or the merchandise produced, manufactured, or exported by the company")[97]. The treatment of tax credits on dividends is manifestly not relevant to the present dispute.

(v) Summary and conclusion

6.85 In light of the above, we do not consider that the USDOC applied a correct interpretation of the Article 1.1(b) term "benefit" when finding that the "benefit" conferred on BSC by pre-1985/86 "financial contributions" by the United Kingdom Government to BSC passed through to, and continued to "benefit", UES and BSplc/BSES. For this reason, the USDOC effectively failed to establish "benefit" to UES and BSplc/BSES. Accordingly, the USDOC failed to demonstrate that any subsidy was bestowed directly or indirectly on the produc-

[96] Sections of the *General Issues Appendix*, appended to *Final Affirmative Countervailing Duty Determination; Certain Steel Products from Austria*, 58 Fed. Reg. 37217, at 37262.

[97] See Attachment 2.8, para. 23.

tion, by UES and BSplc/BSES respectively, of leaded bars imported into the United States during 1994, 1995 and 1996.

6.86 We recall that, consistent with Articles 19.1, 19.4 and 21.2 of the SCM Agreement, Article VI:3 of the GATT 1994, and the object and purpose of countervailing duties as expressed in footnote 36 to Article 10, no countervailing duty may be imposed on an imported product if no (countervailable) subsidy has been bestowed directly or indirectly on *inter alia* the production of that imported product. As a result of the three administrative reviews at issue, the United States imposed countervailing duties on 1994, 1995 and 1996 imports of leaded bars, without showing that any subsidy had been bestowed directly or indirectly on the production of those imports. In principle, therefore, the countervailing duties imposed as a result of the USDOC's 1995, 1996 and 1997 administrative reviews are not in accordance with the premise underlying Articles 19.1, 19.4 and 21.2 of the SCM Agreement, Article VI:3 of the GATT 1994, and the object and purpose of countervailing duties as expressed in footnote 36 to Article 10. For this reason, the imposition of countervailing duties as a result of the USDOC's 1995, 1996 and 1997 administrative reviews constitutes a violation of the US obligation under Article 10 of the SCM Agreement to "take all necessary steps" to ensure that its countervailing duties are "in accordance with" with Article VI:3 of the GATT 1994 and the terms of the SCM Agreement. Accordingly, we conclude that the countervailing duties imposed as a result of the USDOC's 1995, 1996 and 1997 administrative reviews are inconsistent with Article 10 of the SCM Agreement.

3. The EC Article 19.4 claim

(a) Arguments of the parties

6.87 We set forth below our understanding of the principal arguments advanced by the parties.

(ii) The European Communities

6.88 The European Communities submits that no countervailing duties should have been levied on imports of leaded bars produced by UES or BSplc/BSES because those imports were not subsidized. By imposing countervailing duties on imports that were not subsidized, the European Communities asserts that the United States levied countervailing duties "in excess of the amount of the subsidy found to exist" in respect of those imports, contrary to Article 19.4 of the SCM Agreement.

6.89 According to the European Communities, any Article 19.4 determination of the "amount of subsidy" necessarily requires a measurement of the amount of "benefit" conferred. This requires comparing the terms of the financial contribution at issue with those that would have prevailed in the marketplace absent the subsidy. The European Communities argues that, by virtue of Article 14 of the SCM Agreement, this comparison must be made by reference to a market benchmark. Pursuant to the requisite analysis under Article 14 of the SCM Agreement, the European Communities submits that a private purchaser of a company or productive assets thereof at fair market value obtains no benefit from

subsidies previously granted to the seller. Any benefit stream established for the purposes of allocating the benefit granted to the previous owner ceases to apply. Consistent with the market benchmark established in Article 14 of the SCM Agreement, the price paid in an arm's-length transaction is equal to the fair market value. Hence, for the purposes of Article 19.4 of the SCM Agreement, the "amount of the subsidy" is zero, and there can be no "subsidization per unit" of the product under investigation.

(iii) The United States

6.90 The United States submits that the USDOC administrative reviews at issue were consistent with Article 19.4 of the SCM Agreement. According to the United States, the SCM Agreement only directs (in Article 1) that the investigating authority identify the existence of a "subsidy," including a subsidy "benefit," as of the time of the subsidy bestowal and (in Article 14) that the investigating authority measure the identified subsidy "benefit" through certain market-rate benchmarks as of the time of the subsidy bestowal.

(b) Evaluation by the Panel

6.91 The European Communities also challenges the consistency of the three administrative reviews at issue with Article 19.4 of the SCM Agreement. The European Communities' Article 19.4 claim repeats many of the arguments advanced in support of its Article 10 claim. We note that a panel "need only address those claims which must be addressed in order to resolve the matter in issue in the dispute."[98] Since we have already found that the three administrative reviews at issue, and the countervailing duties to which they gave rise, are inconsistent with Article 10 of the SCM Agreement, we do not consider it necessary to address the European Communities' Article 19.4 claim.

VII. CONCLUSION

7.1 For the above reasons, we conclude that by imposing countervailing duties on 1994, 1995 and 1996 imports of leaded bars produced by UES and BSplc/BSES respectively, the United States violated Article 10 of the SCM Agreement.

7.2 In light of Article 3.8 of the DSU, we therefore conclude that there is nullification or impairment of the benefits accruing to the complainant under the GATT 1994.

[98] *United States - Measures Affecting Imports of Woven Wool Shirts and Blouses from India* ("US – Wool Shirts and Blouses"), WT/DS33/AB/R and Corr. 1, adopted 23 May 1997, DSR 1997:I, 323, at 340.

VIII. RECOMMENDATION

8.1 Consistent with the first sentence of Article 19.1 of the DSU, we recommend that the United States bring the aforementioned measures into conformity with the SCM Agreement.

8.2 By virtue of the second sentence of Article 19.1 of the DSU, we may "suggest" ways in which the United States could implement our recommendation. The European Communities asked the Panel "to suggest that the United States amend its countervailing duty laws to recognize the principle that a privatization at market price extinguishes subsidies." The European Communities has not identified any provision of US law that **requires** the imposition of countervailing duties in the circumstances of the present dispute. Thus, we are unable to make the suggestion requested by the European Communities. However, we note that the United States has continued to apply its change-in-ownership methodology during the course of the present dispute.[99] We would suggest that the United States takes all appropriate steps, including a revision of its administrative practices, to prevent the aforementioned violation of Article 10 of the SCM Agreement from arising in the future.

[99] The USDOC recently published the results of its 1998 administrative review of the 1992 *Leaded Bars* determination (see 64 Fed. Reg., Number 154).

ATTACHMENT 1.1

FIRST SUBMISSION OF THE EUROPEAN COMMUNITIES
(27 April 1999)

TABLE OF CONTENTS

I. INTRODUCTION

1. This dispute arises under Articles 1.1(b), 10, 14, and 19 of the WTO Agreement on Subsidies and Countervailing Measures ("ASCM"). The dispute concerns the failure of the US authorities to recognize the impact of an arm's-length and fair market value privatization transaction on subsidies granted to a state-owned enterprise prior to its privatization. Specifically, the United States has persisted in its pre-ASCM practice of imposing countervailing duties on the products of private companies that have purchased formerly state-owned firms, or productive units thereof, at fair market value in transparent arm's-length privatization transactions.[1] As a result, private companies that never received a government financial contribution nor any benefit therefrom have been found to be liable for countervailing duties by the United States.[22] This practice is a direct breach of the obligations of the United States to the European Communities under the ASCM.

2. Under the ASCM, countervailing duties may be imposed to offset a subsidy, but they may go no further. Countervailing duties are designed to offset, not punish. By imposing countervailing duties where no "benefit" and hence no "subsidy" is enjoyed by a company under investigation, the United States ignores both economic common sense and the "benefit to the recipient" standard for which the United States successfully militated in the Uruguay Round negotiations. The US approach is fundamentally at odds with the open rules-based trading system of the WTO. The WTO system is designed to encourage economic rationality, privatization, and predictability of treatment for WTO member nations. Instead, by imposing countervailing duties where no subsidy exists, the United States has effectively created a major disincentive for privatization by exposing purchasers of state-owned companies to massive, unjustified, and unpredictable US countervailing duties. The ASCM allows for no such punitive measures.

3. This submission is divided into five sections. Section I discusses the evolution of the US countervailing duty rules applicable to this dispute and examines the history of the US imposition of countervailing duties in *Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating from the United Kingdom*

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[1] The European Communities are using the terms "arm's-length transaction" and "fair market value" in accordance with their accepted meanings:

- *Arm's length transaction.* Said of a transaction negotiated by unrelated parties, each acting in his or her own self interest; the basis for a fair market value determination. A transaction in good faith in the ordinary course of business by parties with independent interests. ... The standard under which unrelated parties, each acting in his or her own best interest, would carry out a particular transaction.
- *Fair market value.* The amount at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of the relevant facts.

Black's Law Dictionary, West Publishing Co. (6th Ed. 1990).

[2] Since the introduction of the current US "privatization methodology" in 1993, the United States has *never* found pre-privatization subsidies eliminated as the result of an arm's-length market value privatization. Nor has the United States ever examined whether a privatized company was itself a recipient of a benefit from financial contributions to state-owned enterprises.

("*UK Leaded Bars*") and subsequent administrative reviews of that decision. Section II illustrates why arm's-length privatization transactions capture the residual value of any government subsidy previously conferred on a seller and examines the DOC practice as specifically applied in these cases. Section III details the procedures between the European Communities and the United States with respect to this dispute. Section IV sets forth the legal arguments as to why the challenged US Department of Commerce ("DOC") determinations in particular, and, more generally, the US practice which they embody, violate US obligations to the European Communities pursuant to the ASCM. Section V contains the European Communities' conclusion.

II. FACTUAL BACKGROUND

4. This Section is divided into two parts. Part A discusses the evolution of the US countervailing duty rules applicable to this dispute. It begins in 1989 and traces the history of the current US practice, which has not changed despite the entry into force of the ASCM as of 1 January 1995. Part B examines the imposition of countervailing duties by the United States on certain lead and bismuth carbon steel products ("leaded bars") originating from the United Kingdom. These duties were originally imposed in 1993 following an investigation by US authorities, under the US approach of allocating non-recurring subsidies over time.[3] The practices that are the subject of this dispute have been maintained in a number of administrative and judicial rulings since the effective date of the ASCM (1 January 1995). The European Commission will describe first to the evolution of the current US practice.

A. History of United States Policy and Practice Concerning the Effect of Privatization on Subsidies Previously Bestowed on a State-Owned Enterprise

5. The impact of an arm's-length privatization on the countervailability of subsidies previously bestowed on a state-owned enterprise was first addressed by the United States in its 1989 administrative review of the US countervailing duty order on *Lime from Mexico*.[4] The decision in *Lime from Mexico* is attached as

[3] This issue arises because of the US practice of allocating the benefit of non-recurring subsidies over a period of time corresponding to the useful life of the firm's assets. Consequently, subsidies granted some years before the investigation may be countervailed, and duties may continue to apply until the end of the depreciation period.

[4] *Lime from Mexico*; *Preliminary Results of Changed Circumstances Countervailing Duty Administrative Review*, 54 Fed. Reg. 1753, 1754-55 (17 January 1989) ["*Lime from Mexico*"]. The DOC revoked the US countervailing duty order on lime from Mexico later that year (retroactively effective to 24 August 1986, the date of Mexico's accession to the GATT), thus terminating the changed circumstances review. *Lime from Mexico; Final Results of Changed Circumstances Countervailing Duty Administrative Review and Revocation of Countervailing Duty Order*, 64 Fed. Reg. 49324 (30 November 1989).

Three years earlier the United States had been asked to address the substantially similar issue of whether there was a "pass through" of prior subsidies in an arm's-length sale of assets in the context

Exhibit EC-1. The Government of Mexico requested that US authorities examine the purchase of a former state-owned lime producer to determine (i) whether the purchase of the former state-owned producer "was at arm's-length", and (ii) whether, as a result, subsidies bestowed on the former state-owned enterprise no longer benefited the company's new owner.[5] Mexico's request was based on a fundamental economic principle - that the residual value of any subsidies previously bestowed on a state-owned enterprise is fully accounted for in the purchase price and therefore does not provide any benefit *to an arm's-length purchaser paying fair market value*.

6. The US Department of Commerce examined two issues in detail in the *Lime from Mexico* review: (i) whether ownership was actually transferred to private investors such that the government-owned company ceased to exist as a government enterprise, and (ii) whether any subsidy benefits earlier provided to the state enterprise continued to provide advantage to the new private owners.

7. After examining the transaction and purchase contract, the DOC determined that ownership of the enterprise had been transferred from the state to private investors and, as a result, the company "was no longer a government-owned company". Turning next to the question of whether subsidies previously received by the state-owned enterprise continued to benefit the company's new owners after the privatization, the United States authorities based their analysis "on the proposition that, to the extent that the price paid for a government-owned company reflects the company's market value, we believe it is reasonable to presume ... that any countervailable benefits previously granted to the company are fully reflected in the purchase price and that such benefits are not passed through to the purchaser".[6]

8. Finding that "[u]ltimately, a company's value is whatever price the market will bear", the DOC examined the conditions of the sale, assuring itself that the bidding process was open, market forces were allowed to operate, and indicators of the company's value were central to the negotiation and sale. Finding the transaction to have occurred at arm's length, the DOC determined that the price the private investors paid reflected the former state-owned enterprise's "market value" and, therefore, that "no benefits" to the former state-owned enterprise passed through to the new private owners.[7]

9. The United States next examined the effect of a privatization sale in 1993. At that time, the United States authorities responsible for assessing countervailing duties completely reversed course. This change in position first took place in

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of a bankruptcy. See *Final Affirmative Countervailing Duty Determination; Oil Country Tubular Goods from Canada*, 51 Fed. Reg. 15037, 15042 (22 April 1986) ["*OCTG from Canada*"]. In *OCTG from Canada*, the DOC held that "in an arm's-length transaction, such as this one, *subsidies*, if there are any, *are not passed through*". Ibid. (emphasis added).

[5] *Lime from Mexico*; *Preliminary Results of Changed Circumstances Countervailing Duty Administrative Review*, 54 Fed. Reg. at 1754.

[6] *Lime from Mexico*; *Preliminary Results of Changed Circumstances Countervailing Duty Administrative Review*, 54 Fed. Reg. Benefits previously countervailed included equity infusions, interest-free loans, and other preferential loans.

[7] See page 1755 of *Lime from Mexico*.

the context of a steel countervailing duty investigation requested by the US domestic steel industry. As explained in greater detail below[8], in 1993 the US authorities held that "a company's sale of a 'business' or 'productive unit' does not alter the effect of previously bestowed subsidies ... the sale does *nothing* to alter the subsidies enjoyed by that productive unit".[9]

10. The US authorities ruled that henceforth in US countervailing duty determinations, subsidies previously bestowed on state-owned enterprises would "travel" in their entirety to "their new home" in the unrelated private companies purchasing the previously state-owned business at arm's length for fair market value.[10] By this ruling, the US authorities abandoned the principle they had earlier set forth that, of necessity, an arm's-length market price takes full account of the residual value of any such prior subsidies, and that no benefit conferred on a former state-owned enterprise passes through to the now-private company.

11. Among the rationales offered by US authorities for this new "pass through" practice was the notion that the United States would otherwise "invite [previous] subsidy recipients to sell off units that produce or export countervailed merchandise to the United States" [*e.g.,* the arm's-length market privatizations of previously state-owned enterprises]. The United States also noted that its approach would "not examine the impact of subsidies on particular assets or tie the benefit level of subsidies to changes in the company under investigation".[11]

12. Less than six months later, in July 1993, US authorities again changed course with respect to the treatment of subsidies bestowed on state-owned enterprises that had subsequently been privatized. In a "General Issues Appendix" ("GIA")[12] referred to in several countervailing duty determinations involving flat-rolled carbon steel products (the relevant sections of which are included as Exhibit EC-2 to this submission), the DOC announced a new "privatization methodology", whereby the DOC claimed that "to the extent that a portion of the price paid for a privatized company can reasonably be attributed to prior subsidies, that portion of those subsidies will be extinguished".[13]

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[8] See also paras. 34-37.

[9] *Final Affirmative Countervailing Duty Determination; Certain Hot Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom*, 58 Fed. Reg. 6237, 6240 (27 January 1993) ["*UK Leaded Bars*"]["*1992 Investigation*"] (emphasis added). This document is attached as Exhibit EC- 4. Interestingly, in its preliminary determination, the DOC had decided "not to attribute" to the buyer "*any* subsidies received by BSC" prior to privatization. Ibid. at 6239 (emphasis added). Based on a "reconsideration of the preliminary determination and upon reviewing the comments submitted by the interested parties", the US adopted the opposite position in its final determination. Ibid. at 6240.

[10] *Final Affirmative Countervailing Duty Determination; Certain Hot Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom*, 58 Fed. Reg. at 6240.

[11] *Final Affirmative Countervailing Duty Determination; Certain Hot Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom*, 58 Fed. Reg. at 6240.

[12] "General Issues Appendix", appended to *Final Affirmative Countervailing Duty Determination; Certain Steel Products from Austria,* 58 Fed. Reg. 37217 (9 July 1993). The US authorities' discussion of "privatization" is found at 37259-65. A related discussion of "restructuring" meant to account for the US treatment of "travelling" subsidies to privatized "spin-offs" (other than the company specifically under direct investigation) is contained at page 37265 et seq.

[13] See pages 37262-63 of the GIA.

13. Under the GIA methodology, a "portion" of the purchase price in the sale of a state-owned company is claimed to repay a "portion" of the "remaining" value of prior subsidies.[14] All subsidies provided to the state-owned enterprise prior to privatization would now "travel" to the new private purchaser in an arm's-length market value transaction unless they were found to be "repaid" by the terms of the GIA calculation formula. That formula, *by its own terms*, treats as "irrelevant" the economic issue of whether the transaction was at arm's length for fair market value.[15] Rather, as discussed in Section II below, the GIA formula presumes "irrebuttably" that the private purchaser has benefited from pre-privatization subsidies and, after assessing the *existence* of a subsidy *to the prior owner*, simply determines the amount of such subsidies "passing through" to the buyer.

14. The "repayment" methodology of the US authorities purports to allocate past subsidies between the recipient of those subsidies and the purchaser of the company or productive assets previously owned by the recipient. The "allocation" is based on a DOC calculation where the value of past subsidies is amortized over the useful life of assets. Under the DOC approach, the amount of subsidies allocated to a given year before the privatization is divided by the "net worth" of the company in that year. The same ratio is calculated for each pre-privatization year during the useful life of the assets under consideration. The simple average of those ratios is referred to as the "gamma". The gamma is then multiplied by the cash portion of the purchase price of the business paid by the private buyer. The result is subtracted from previously bestowed subsidies. The net amount of subsidies is attributed by DOC as a "pass through" to the buyer.[16] See also Exhibit EC-3, which contains a sample calculation using the DOC's "privatization methodology".[17]

15. A simple example of this approach would be as follows: Assume a government company received past subsidies during its DOC-assigned allocation period and that, under the DOC formula, the simple average of the ratio of the company's subsidies to net worth during that period was 0.30. Further assume the company was sold in an arm's-length transaction for the market price of £2,000 million, £600 million in cash and £1,400 million in assumed liability. Under its self-derived formula, DOC would find that only 9 per cent of the purchase price (£180 million) "repays" the subsidy (0.30 x £600 million = £180 million; and £180 million/£2000 million = 9%). If the seller had received subsidies with a DOC-derived net present value of £700 million, DOC would find that £520 mil-

[14] See page 37263 of the GIA.
[15] See page 37264 of the GIA.
[16] See page 37263 of the GIA.
[17] As discussed at length in Section II and Exhibit EC-3 below, under the GIA "repayment" methodology it is effectively impossible to avoid the pass-through of subsidies previously bestowed on an unrelated state-owned enterprise. Average prior subsidies would need to exceed the average net worth of the company. For instance, in an arm's-length privatization of assets sold at book value (inclusive of the full amount of a previous subsidy grant made five years prior to privatization), the GIA methodology results in only a fraction of the value of the subsidy being "repaid" and eliminated. See Exhibit EC-3.

lion of those subsidies "travel" to the buyer and £180 million remain with the seller. Whether a buyer pays fair market value has *no* effect on the DOC calculations.

16. The 1993 GIA also sets forth pre-ASCM US practice in several other areas. First, the DOC determined that it would "not require a subsidy bestowed on a steel producer to confer a demonstrable 'competitive benefit' on that producer in order to be countervailable".[18] Second, the DOC expressly rejected any notion that "the fair market value price must include any remaining economic benefit from the subsidies", or that "privatization extinguishes all remaining unamortized subsidies" as it "rests on the assumption that subsidies must confer a demonstrated benefit on production in order to be countervailable" and "this is contrary to the CVD law, in which is embedded the *irrebuttable presumption* that non-recurring subsidies benefit merchandise produced by the recipient over time"[19] (emphasis added). Third, the DOC held that "the countervailable subsidy (and the amount of the subsidy to be allocated over time) is *fixed* at the time the government provides the subsidy. The privatization of a government-owned company, *per se*, *does not and cannot* eliminate this countervailability". (emphasis added).

17. In this new GIA "privatization methodology", the DOC also set forth a method by which the United States purports to account for the sale of a portion of the assets (a "productive unit") of an investigated company ("selling company").[20] This is referred to as the "spin-off" methodology.[21] "Spin-off" refers to the sale of a productive unit or division other than the unit under investigation that occurs before the privatization under consideration in a case. If, for example, a respondent in a countervailing duty investigation sold a division prior to the period of investigation, the DOC would purport to determine whether a portion of the amount of untied grants[22] received prior to the sale would "travel" or "pass through" to this "spun-off" division. US authorities do not perform the "spin-off" calculation by simply apportioning any previous untied grants on the basis of the ratio of assets of the division to the company. Rather, as with the new privatization methodology, a portion of the sales price is said to be allocable to previously received subsidies, and the DOC performs a "pass through" calculation on this portion of the previous subsidies to set the amount to attribute to the spun-off company. The amount that does not "pass through" to the spun-off company is not treated as "extinguished"; rather, the subsidies not "passed through" are deemed to remain in the benefit stream of the selling company. This approach also serves to increase subsidies attributable to a company under investigation by the United States.[23]

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[18] See page 37261 of the GIA.
[19] See page 37263 of the GIA.
[20] See page 37268 of the GIA.
[21] See page 37268 of the GIA.
[22] Subsidies deemed to benefit all production are referred to as "untied ".
[23] See "Restructurings" section of the GIA at 37268-69. A few months after setting forth the new GIA rules, US authorities applied them to the UK Leaded Bars case (see note and accompanying text, above). In particular, DOC reversed its previous conclusion that "the sale does nothing to alter the subsidies enjoyed" on the basis that it was "not supported by substantial evidence and not other-

18. The United States authorities' new treatment of privatization and restructuring was shortly thereafter challenged in a court action.[24] In ruling on the issue, the US Court of International Trade ("CIT") ruled that the DOC privatization methodology was unlawful "to the extent it states previously bestowed subsidies are passed through to a successor company sold in an arm's-length transaction".[25] The Court reasoned:

> Where a determination is made a given transaction is at arm's-length, one must conclude that the buyer and seller have negotiated in their respective self-interests, the buyer has taken into consideration all relevant facts, and the buyer has paid an amount which represents the market value of all it is to receive. Because the countervailable benefit does not survive the arm's length transaction, there is no benefit conferred to the purchaser and, therefore, no countervailable subsidy within the meaning of [the US CVD statute]. The purchaser, thus, will not realize any competitive countervailable benefit and any countervailable duty assigned to it amounts to a penalty. ...[26]

19. The CIT rulings regarding the GIA "privatization methodology" (as applied under pre-ASCM law in the United States) were themselves challenged by US steel producers. The Court of Appeals for the Federal Circuit ("CAFC") reversed the CIT decision.[27] The Court reasoned that the DOC methodology as set forth in the GIA "correctly recognizes that a number of scenarios are possible: the purchase price paid by the new, private company might reflect partial repayment of the subsidies, or it might not".[28]

20. These decisions, like the GIA itself, were based upon the US countervailing duty law prior to the entry into force of the ASCM on 1 January 1995. The United States approved the ASCM and the remainder of the Uruguay Round Agreements in December 1994 by virtue of the Uruguay Round Agreements Act ("URAA").[29] In proposing the adoption of the URAA, the Clinton Administration transmitted to Congress a so-called "Statement of Administrative Action" ("SAA"), representing the "authoritative expression by the Administration concerning its views regarding the interpretation and application of the Uruguay Round Agreements, both for purposes of US international obligations and domestic law".[30] In a number of important areas, however, the transposition of the

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wise supported by law". Remand Determination: *Certain Hot Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom* (12 October 1993) at 2.

[24] *Inland Steel Bar Co. v. United States*, 858 F. Supp. 179 (CIT, 7 June 1994); *Saarstahl, AG v. United States*, 858 F. Supp. 187 (CIT, 7 June 1994).

[25] *Saarstahl*, 858 F. Supp. at 195.

[26] *Saarstahl*, 858 F. Supp. at 193-94.

[27] *Saarstahl, AG v. United States*, 78 F.3rd 1539 (Fed. Cir. 1996); *Inland Steel Bar Co. v. United States*, 86 F.3d 1174 (Fed. Cir. 1996).

[28] *Saarstahl, AG v. United States*, 78 F.3rd at 1544.

[29] Uruguay Round Agreements Act, Pub. L. No. 103-465, 108 Stat. 4809 (1994) ("URAA").

[30] Statement of Administrative Action, accompanying H.R. 103-5110 (1994), reprinted in 1994 U.S.C.C.A.N. 3773, 4040.

ASCM into domestic law was incomplete. The URAA did not expressly amend the GIA with regard to privatization. Rather the URAA simply provides:

> [a] change in ownership of all or part of a foreign enterprise or the productive assets of a foreign enterprise does not by itself require a determination by the administering authority that a past countervailable subsidy received by the enterprise no longer continues to be countervailable, even if the change in ownership is accomplished through an arm's length transaction.[31]

21. The Statement of Administrative Action explained the US position in greater detail:

> Section 771(5)(F) provides that a change in the ownership of "all or part of a foreign enterprise" (*i.e.*, a firm or a division of a firm) or the productive assets of a firm, even if accomplished through an arm's-length transaction, does not by itself require Commerce to find that past countervailable subsidies received by the firm no longer continue to be countervailable. ... Section 771(5)(F) is being added to clarify that the sale of a firm at arm's-length does not automatically, and in all cases, extinguish any prior subsidies conferred. Absent this clarification, some might argue that all that would be required to eliminate any countervailing duty liability would be to sell subsidized productive assets to an unrelated party. Consequently, it is imperative that the implementing bill correct and prevent such an extreme interpretation. The issue of privatization of a state-owned firm can be extremely complex and multifaceted. While it is the Administration's intent that Commerce retain the discretion to determine whether, and to what extent, the privatization of a government-owned firm eliminates any previously conferred countervailable subsidies, Commerce [the US Department of Commerce] must exercise this discretion carefully through its consideration of the facts of each case and its determination of the appropriate methodology to be applied.[32]

22. The idea of including specific language in the URAA and SAA to express the view that arm's-length privatizations and changes in ownership do not extinguish subsidies granted to former state-owned enterprises was aggressively championed by lobbyists representing US domestic steel, lumber, and semiconductor industries.

23. The URAA and SAA language on privatization was enacted over the contemporaneous objections of many of the United States' most important trading partners, including the European Union and its Member States. Along with other government representatives, the European Union informed the United States that the new US implementing legislation regarding treatment of privatizations under

[31] URAA Section 771(5)(F); 19 U.S.C. § 1677(5)(F).
[32] SAA at 928 (1994), reprinted in 1994 U.S.C.C.A.N. 3773, 4240.

the ASCM contradicted both the language and intent of the ASCM and, as a result, contravened US obligations under the SCM Agreement.[33]

24. DOC has not changed its practices subsequent to the passage of the URAA and entry into force of the ASCM.[34] US authorities applied the pre-ASCM GIA methodology in the cases that are the subject of this proceeding, all of which are post-ASCM. The US authorities have claimed that "the Uruguay Round Agreements Act (URAA) is not inconsistent with and does not overturn the Department's [pre-ASCM] GIA methodology", despite revisions to US practice mandated by the ASCM and despite objections to the US practice voiced by the European Union and a number of other WTO Members.[35]

25. The United States has never found pre-privatization subsidies fully "repaid" or extinguished under the GIA. Indeed, as noted, DOC practice has effectively eliminated the possibility that an arm's-length privatization transaction could account for any pre-privatization subsidy. Rather, DOC has forced these subsidies to "travel" to arm's-length market value purchasers. The United States has simply assumed irrebuttably the existence of subsidies without determining whether privatized companies involved in US countervailing duty investigations are themselves the "recipients" of "financial contributions" conferring a "benefit" within the meaning of US law. In sum, the US authorities have not deviated from the privatization "pass through" calculation methodology set forth in the GIA.

26. In its final countervailing duty regulations, published on 25 November 1998, the DOC did not promulgate additional regulations regarding privatization or change in ownership. Nonetheless, the DOC did re-emphasize several points.[36] First, the DOC stated that the position that an arm's-length privatization transaction at market value extinguishes subsidy is an "extreme position" that would require a "strained interpretation" of the URAA. Second, DOC restated its "refusal" to examine "subsequent events", *i.e.*, whether new private owners enjoy benefits from subsidies conferred on state-owned firms prior to privatization or "whether a subsidy confers a competitive benefit upon the subsidy recipient or *its successor*".[37]

27. In sum, the DOC has made no attempt in any of the above-referenced determinations to examine or explain what benefits from pre-privatization subsidies were provided to companies following an arm's-length privatization or sale of assets at fair market value. The US methodology, as applied by the DOC, has

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[33] "GATT Signatories Warn US Over Implementing Legislation on AD, CVD", *Inside US Trade*, Vol. 12, No. 28 (15 July 1994); "EU Warns Congress on Three Provisions of GATT Implementing Bill," id., Vol. 12, No. 35 (2 September 1994); see also "Foreign Governments Call on Commerce to Change CVD Policy", id., Vol. 15, No. 28 (11 July 1997).

[34] We recall that the pre-ASCM US practice regarding privatizations has been the subject of a GATT dispute settlement panel between the US and the EC. See Section III below.

[35] *Certain Hot Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom*, 61 Fed. Reg. 58377, 58379 (14 November 1996) ["*British Steel plc 1995 Administrative Review*"]. This report is attached as Exhibit EC-5.

[36] *US Department of Commerce, Final Countervailing Duty Regulations*, 19 C.F.R. § 351.524, 63 Fed. Reg. 65348, 65415 (25 November 1998).

[37] Ibid., (emphasis added).

relied on a presumption based on pre-ASCM practice that benefits from pre-privatization subsidies pass through to a private owner without the need to determine that "benefit " has been conferred on that owner as mandated by the ASCM. This irrebuttable presumption has been applied to imports of leaded bar products originating from the United Kingdom, as will be shown in the following section.

B. History of US Imposition of US Countervailing Duties on Certain Lead and Bismuth Carbon Steel Products Originating in the United Kingdom

28. On 8 May 1992 the United States initiated a countervailing duty investigation against imports of leaded bars originating from the United Kingdom and other countries. On 27 January 1993 the US Department of Commerce issued a final determination imposing countervailing duties on imports of such products. This determination is attached as Exhibit EC-4. Four administrative reviews have since been carried out by the DOC to set the final CVD rates on imports of subject merchandise entering the United States. The results of the second, third, and fourth reviews initiated pursuant to applications made in 1995, 1996, and 1997, respectively, are the subject of this dispute under the ASCM. These reviews are attached as Exhibit EC-5, EC-6 and EC-7.

29. *British Steel Corporation ("BSC")* was created in 1967 by means of the Iron and Steel Act, which brought into public ownership most of the UK's steel-making facilities. The state-owned BSC was thereafter the main producer and exporter of leaded bars from the United Kingdom.

30. *United Engineering Steels ("UES"*) was formed in 1986 as a joint venture corporation equally owned by BSC and the privately-owned *Guest, Keen and Nettlefolds ("GKN").* Both BSC and GKN sold productive assets to the joint venture in exchange for a 50%/50% shareholding. More particularly, BSC contributed a major portion of its Special Steel Business, which produced engineering steels, while GKN contributed its Brymbo Steel Works and its forgings business. The DOC determined that "UES was created after several years of difficult, arm's length negotiations between BSC and GKN".[38] The valuation and sale of assets to the UES joint venture fully reflected commercial considerations, for neither BSC nor GKN controlled UES. The DOC determined in the original CVD investigation that UES was "an independent joint venture company, managed as a separate corporate entity from its parent companies BSC and GKN".[399] Furthermore, the DOC "found nothing during verification which indicates that the negotiations for UES were not held at arm's length".[40].

31. BSC was privatized through a two-step process. In February 1988 the UK Government introduced the British Steel Bill, which made provision for the

[38] 1992 Investigation, 58 Fed. Reg. at 6240. See Exhibit EC-4.
[39] Ibid.
[40] Ibid. and comment 4 at 6244 (concluding that the UES transaction was "an arm's length transaction in which BSC acted consistently with commercial considerations").

property, rights and liabilities of BSC to be transferred to a new public limited company named British Steel Public Limited Company ("British Steel plc"). British Steel plc was created on 26 July 1988 and on 5 September 1988 assumed the property, rights and liabilities of BSC. Then, in December 1988, British Steel plc was privatized through an open offering of its shares in London and other major financial centres in what was a fully transparent sale at fair market value. With regard to privatization by open share offering on the stock exchange, the DOC found that "the sale of BS plc was at arm's length, for fair market value and consistent with commercial considerations".[41]

32. As a result of the privatization, UES' shareholders - GKN and British Steel plc - were both fully in private hands. The privatization had no effect on the pattern of leaded bar exports from the United Kingdom to the United States. UES continued to be the main UK producer and exporter of the product to the United States.

33. On 20 March 1995 British Steel plc purchased GKN's holding in UES, giving British Steel plc 100 per cent of the shares of UES. British Steel renamed UES *British Steel Engineering Steels ("BSES").* In an effort to take account of this transaction, the DOC made separate CVD findings with respect to the time period before 20 March 1995 and the time period thereafter, *i.e.*, the DOC considered UES to be the relevant producer and exporter of leaded bars before 20 March 1995 (including for the 1995 administrative review and the initial portion of the 1996 administrative review) and British Steel plc/BSES to be the relevant producer and exporter for the latter portion of the 1996 administrative review and for the 1997 administrative review (see below).[42]

US DOC Determinations

34. The original *Leaded Bars* investigation was initiated on 8 May 1992 and concluded on 27 January 1993 when the DOC published its final affirmative countervailing duty determination. As stated, this determination is attached as Exhibit EC-4. That determination found that subsidies within the meaning of the US CVD law had been provided to UES that were attributable, as a result of amortisation, to the period of investigation (calendar year 1991). The DOC determined a countervailing duty weighted average margin of 12.69 per cent for UES.

35. None of the financial contributions at issue had been granted to UES. Rather, each had been provided to BSC prior to 1985/1986. In accordance with the methodology described in paragraph 4 above, they were considered non-

[41] *Final Results of Redetermination Pursuant to Court Remand on General Issues of Privatization, British Steel plc v. United States*, 17 July 1995 (unpublished) at 18; see also *Remand Determination of US Department of Commerce on General Issues of Privatization, Certain Hot Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom*, 12 October 1993 (unpublished) ["*1993 Remand Determination*"].

[42] The DOC chose to treat British Steel plc and BSES "as one company for purposes of this proceeding". See, e.g., *Certain Hot Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom*, 63 Fed. Reg. 18367, 18374 (15 April 1998) ["*British Steel plc 1997 Administrative Review*"]. See Exhibit EC-7.

recurring and therefore allocated over the useful life of assets, a period which was originally 15 years but was subsequently extended to 18 years. Thus, all relevant financial contributions countervailed had been made to BSC prior to UES' formation (and to BSC's 1988 privatization). UES had not received any subsidy and, but for the application of the US "pass through" formula, no countervailing duties would have been imposed.

36. As stated, the DOC specifically determined that transactions between BSC, GKN, and UES were conducted at arm's length and fully reflected commercial considerations. Nonetheless, the DOC found that "a company's sale of a business or productive unit does not alter the effect of previously bestowed subsidies" and that disposed assets "take a portion of the benefits with them when they 'travel to their new home'".[43]

37. The DOC thus found that pre-privatization financial contributions to the then state-owned BSC had "passed through" to UES following the latter's arm's-length acquisition of assets from BSC in 1986. The DOC further determined that these amounts were not tied to any particular product and should therefore be allocated over BSC's entire production including its leaded bar production. As a result, the DOC attributed to UES subsidies that had been provided to BSC.

38. In October 1993, the DOC modified its previous determination with respect to UES. This modification, set forth in the so-called *Remand Determination*, was based on revised US "privatization" and "restructuring" practices set out in the General Issues Appendix to *Certain Steel Products from Austria* in July 1993.[44] In the GIA, the DOC stated that it may no longer be assumed that the entire amount of the subsidies allocated to a certain productive unit "travels" with that unit when it is sold; rather, a portion of the sales price of the productive unit may represent the "repayment" of prior subsidies.[45]

39. Following the original imposition of countervailing duties on UES in 1993, four administrative reviews have been carried out by the DOC to set the CVD rate on imports of leaded bars entering the United States in 1994, 1995, 1996, and 1997, respectively. The first of those reviews (like the original determination itself) was initiated before the entry into force of the ASCM.[46] Hence, this Panel concerns the second, third, and fourth administrative reviews regarding

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[43] 1992 Investigation, 58 Fed. Reg. at 6240. See Exhibit EC-4.

[44] 58 Fed. Reg. 37217, 37225 (9 July 1993).

[45] This approach was also followed by the DOC in the first administrative review of the countervailing duty order, concluded in August 1995 (the 1994 Review), which is not before this Panel, as it was initiated before the entry into force of the ASCM. The DOC expressly stated in that review that all of its conclusions were based on US law as it stood on 31 December 1994, i.e., on provisions not yet amended to take the ASCM into account. It should be noted, however, that DOC has followed this very *same* approach in all later reviews, notwithstanding the intervening entry into force of the ASCM.

[46] The first review was initiated on 15 April 1994. A final determination was issued by the DOC on 24 August 1995, imposing a countervailing duty rate on UES of 5.05%. *Certain Hot Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom,* 60 Fed. Reg. 44009 (24 August 1995) ["*British Steel plc 1994 Administrative Review* "].

the years 1995, 1996, and 1997, respectively, which were initiated after the entry into force of the ASCM.[47]

The 1995 Review

40. The 1995 Review (attached as Exhibit EC-5) was initiated on 14 April 1995. It was the first review of the leaded bars order subject to the requirements of the ASCM, which, as stated, the United States was to have transposed into national legislation effective 1 January 1995. The 1995 Review covered entries of leaded bars exported to the United States by UES during calendar year 1994. In its final determination published on 14 November 1996, the DOC imposed a countervailing duty of 1.69 per cent against UES; this was once more entirely attributable to subsidies previously granted to BSC.[48] The DOC disregarded both (i) UES' explanation that it had received no subsidies of any sort and (ii) more particularly, UES' explanation that it had received no benefit by virtue of financial contributions provided to BSC before BSC's 1988 privatization. On this latter point, the DOC failed to examine whether UES was the recipient of any "benefit" conferred by the UK Government, notwithstanding UES' submissions to DOC that such a determination was now required under Article 1.1(b) of the ASCM before countervailing duties could be legally imposed.

41. Rather, the DOC conducted the 1995 Review under the "privatization" and "restructuring" rules set forth in the pre-ASCM DOC General Issues Appendix. Both UES and the UK Government expressed serious concerns regarding this approach. The DOC replied that the "URAA [transposing the ASCM into US law] is not inconsistent with and does not overturn the Department's General Issues Appendix methodology or its findings in the [1993] Lead Bar Remand Determination".[49] DOC referred to the language of Section 771(5)(F) of the URAA, quoted above, which it claimed "leaves discretion to the Department with regard to the impact of a change in ownership on the countervailing of past subsidies".[50] DOC also referenced the Statement of Administrative Action, produced by the Clinton Administration and submitted to the US Congress, also quoted above, which indicates that the DOC has discretion "to determine whether, and to what extent, the privatization of a government-owned firm eliminates any previously conferred countervailable subsidies".[51]

42. In the 1995 Review final determination, DOC stated that the US Court of Appeals for the Federal Circuit "recently issued a ruling supporting our determination that subsidies are not necessarily extinguished as a result of the sale of an

[47] Article 32:3 ASCM. These reviews are attached as Exhibits EC-5, EC-6 and EC-7 respectively.
[48] *Certain Hot Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom*, 61 Fed. Reg. 58377 (14 November 1996) ["*British Steel plc 1995 Administrative Review*"], attached as Exhibit EC-5.
[49] *Certain Hot Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom*, 61 Fed. Reg. at 58379.
[50] Ibid.
[51] Ibid.

enterprise in an arm's length transaction".[52] DOC's reliance on the Court of Appeals decision ignored the fact that the ruling at issue expressly concerned US law as it existed *before* the ASCM entered into force.[53] Thus, DOC plainly was relying on court-made law that was inconsistent with the ASCM when DOC found a countervailable subsidy to UES during the period covered by the 1995 Review.

The 1996 and 1997 Reviews

43. The 1996 and 1997 Reviews (attached as Exhibits EC-6 and EC-7) covered entries of leaded bars exported to the United States by UES during the calendar years 1995 and 1996. The reviews were initiated on 25 April 1996 and 29 April 1997, respectively. The final DOC determinations were issued on 14 October 1997 and 15 April 1998, respectively.[54]

44. As explained above (see paragraph 33), during the period covered by the 1996 Review, British Steel plc acquired GKN's interest in UES. Pursuant to this transaction between the two private companies that held stakes in UES, UES was changed from a 50-50 joint venture to a wholly-owned subsidiary of British Steel plc, which renamed the firm British Steel Engineering Steels Ltd.

45. With respect to the 1996 Review, the DOC determined that imports during the period prior to the acquisition of the remainder of UES by British Steel plc (*i.e.*, 1 January - 20 March 1995) should be countervailed at a rate of 2.4 per cent. This rate was based on the same position DOC took in the 1995 Review that BSC subsidies "travelled" with the assets sold to UES in 1988. DOC took this position despite (i) UES' purchase of these assets at arm's length and for full commercial consideration and (ii) the subsequent privatization of BSC at arm's length and for full commercial consideration.

46. With respect to the remaining portion of the 1996 Review (21 March to 31 December 1995) and to the 1997 Review (1 January to 31 December 1996), the DOC imposed substantially higher countervailing duties at rates of 7.35 per cent and 5.28 per cent, respectively. These higher CVD rates were based on a determination by DOC that British Steel plc's acquisition of the remaining 50 per cent of UES somehow allowed British Steel plc **itself** to benefit anew from subsidies given to the formerly state-owned BSC, and that UES (newly renamed BSES) was also somehow now benefiting from those subsidies. These hitherto unattributed subsidies had, in DOC's view, somehow sprung back to life and

[52] *Saarstahl, AG v.* United States, 78 F. 3d 1539 (Fed. Cir. 1996), cited in *British Steel plc 1995 Administrative Review*, 61 Fed. Reg. at 58378.

[53] The Court of Appeals in its decision emphasized that the URAA has "profoundly changed the CVD statute as of 1 January 1995". *Saarstahl*, 78 F. 3d at 1543 n.*.

[54] *Certain Hot Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom*, 62 Fed. Reg. 53306 (14 October 1997) ["*British Steel plc 1996 Administrative Review*"] and *Certain Hot Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom*, 72 Fed. Reg. 18367 (15 April 1998) ["*British Steel plc 1997 Administrative Review*"], attached as Exhibits EC-6 and EC-7 respectively.

"rejoined BS plc's pool of subsidies with the company's 1995 acquisition [of UES]".[55]

47. In addition to this newly "rejoined pool", the DOC continued to employ its "restructuring " and "privatization" approaches from the 1993 GIA in order to countervail pre-privatization subsidies to BSC that DOC found had "passed through" to UES in 1986 and remained there despite BSC's privatization in 1988. DOC now found that these subsidies had "passed through" again, this time back to British Steel plc.

48. Rather than assessing whether there existed a benefit to British Steel plc, DOC chose to take the existence of such benefits for granted, supporting this assumption with a 1993 countervailing duty investigation involving a different product from the United Kingdom *("1993 Certain Steel from the UK")*.[56] This investigation is attached as Exhibit EC-8. That decision was, once again, prior to the entry into force of the ASCM. By relying on that DOC decision, DOC avoided examination of whether BSC's privatization eliminated pre-privatization benefits conferred on BSC or whether those BSC benefits had "travelled" to British Steel plc, BSES, or UES. Rather, DOC again championed its view that "[t]he URAA is not inconsistent with and does not overturn the Department's 1993 General Issues Appendix methodology".[57] DOC simply assumed the existence of a benefit to "British Steel plc/BSES/UES" and then calculated such benefits by applying, *inter alia*, findings from the pre-ASCM *1993 Certain Steel from the UK*.

49. As in the 1995 Review, the DOC made no attempt in the 1996 or 1997 Reviews to examine or explain how financial contributions to BSC before that company's privatization had conferred benefits, if any, on British Steel plc, BSES, or UES. By its practice, DOC effectively disregarded the effect both of BSC' s privatization and of the sales of former BSC assets at market prices. Instead, DOC simply assumed the continuous existence of "benefits" to private firms, relying entirely on pre-Uruguay Round US legislation and US practice and ignoring the new requirements of the ASCM. The result has been the imposition of countervailing duties on UES and British Steel plc attributable entirely to prior financial contributions made to BSC.

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[55] *British Steel plc 1997 Administrative Review*, 63 Fed. Reg. at 18369. See Exhibit EC-7.

[56] *Certain Steel Products from the United Kingdom*, 58 Fed. Reg. 37393 (9 July 1993) (attached as Exhibit EC-8), cited in *British Steel plc 1997 Administrative Review*, 63 Fed. Reg. at 18369 (Exhibit EC-7).

[57] *British Steel plc 1997 Administrative Review*, 63 Fed. Reg. at 18369, citing *British Steel plc 1995 Administrative Review*, 61 Fed. Reg. at 58379.

III. THE ECONOMICS OF PRIVATIZATION

A. How Markets Value Companies and Why Privatization in an Arm's-Length Market-Based Sale Necessarily Extinguishes Prior Subsidies to the State-Owned Firm

50. Although the European Communities submit that the concept of market valuation is both well settled and intuitively obvious, it would appear appropriate to explain this term in greater detail. The European Communities are of the view that when a private buyer purchases a company or assets thereof in an arm's-length transaction at market value, the price paid necessarily values and incorporates within the transaction any subsidy previously conferred. If the subsidy increases the value of the company, so will it increase the price that the purchaser must pay. The payment of market price thus necessarily precludes the notion that any " benefit" would have "passed through" to this new private owner as a basic matter of economics.[58] We set forth below four examples.

51. Example 1: The first example is the simplest. Consider a person ("A") who is given £100 through a government financial contribution. This £100 confers a "benefit" on A, as the recipient of the money. A then purchases a chair with the £100. He sells the chair to a unrelated purchaser, B, for its fair market value, £100. This example shows that the "benefit" of the £100 has not in any sense "passed through" to B. The government is £100 poorer and A is £100 richer, both before and after the sale of the chair. B has not benefited at all. He has exchanged £100 for a chair which is worth that amount.

52. Example 2: Assume the same facts as Example 1. However, the chair that A purchased for £100 is no longer worth £100, but instead has increased in value to £125. B purchases the chair for £125. In this example, one readily sees that, like Example 1, no benefit has been conferred on B. A received a benefit of £100 from the government, and made a profit of £25 due to the increased value of his purchased asset, the chair. B has paid fair value for the chair, and the government is £100 poorer.

53. Example 3: Assume the same facts as Example 1, but the value of the chair after its purchase has declined by £25. In this example, B buys the chair for £75, which is its fair market value. A benefits by £100 from the government contribution. B does not benefit from the government contribution, and the government has spent £100. The decline in market value does not benefit B, because the value is market-based, *i.e.*, a function of the productive potential of the asset.

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[58] For a further description of the valuation techniques described herein, see Elhanan Helpman and Paul R. Krugman, Trade Policy and Market Structure (1994); Joseph H. Marren, Mergers & Acquisitions: A Valuation Handbook (1993); Robert W. Kolb and Ricardo J. Rodriguez, Financial Markets (1996); Erich A. Helfert, Techniques of Financial Analysis (1972); O. Letwin, Privatizing the World: A Study of International Privatization in Theory and Practice (1988); Copeland, Long-Term Sources of Funds and the Cost of Capital, in Altman, Handbook of Corporate Finance (1986). See generally United States - *Imposition of Countervailing Duties in Certain Lead and Bismuth Carbon Steel Products Originating in France, Germany and the United Kingdom*, Report of the Panel (unadopted) at paras. 405-430 (attached as Exhibit EC-9).

54. Example 4: Firm A is owned by the state and has received financial contributions for some years. The company is valued at £100 million. Firm B, in the same industry, has the identical type of plant and equipment, but has never received any government assistance. The two companies are put up for sale in a competitive bidding process. The companies will have the same value to prospective purchasers, and they should sell for the same price. This is because a rational purchaser is indifferent between the two firms. The rational purchaser would not offer a higher price for Firm A than for Firm B simply because the former had received a subsidy. Nor would a purchaser value Firm B at a higher amount because it had never received any government assistance.

55. A subsidy benefits its recipient by conferring an economic advantage that the recipient would not otherwise have enjoyed. At its most basic, an economic advantage must either enhance revenue or reduce cost for the benefited firm. For example, a subsidy conferred to support research and development results in reduced current operating cost and enhanced future revenue as the benefits of the research are realized in new or improved products. A grant for new capital equipment, on the other hand, reduces both the operating cost of depreciation and the capital cost of debt financing for the recipient of the grant. Whether in the form of enhanced potential revenue or reduced cost, any advantage is reflected in higher earnings, cash flow, and return on investment than would have been realized in the absence of the benefit.

56. The prospect of enhanced future profits and cash flow is reflected in a company's market value. A publicly traded company's market value is reflected in its market capitalisation, the share value multiplied by the number of shares outstanding. For example, even after adjusting for differences in the book value of equity, the market capitalisation of Microsoft is currently approximately five times higher than that of General Motors. The market perception is that over time, even with lower sales and fewer tangible assets, Microsoft's earnings will exceed those of General Motors. The higher market capitalisation assures that, for a given level of risk, market returns are equalized among available investments.

57. The principles of valuation are widely recognized. The value of a business is the net present value of projected future cash flows. For publicly traded companies, equity markets value the shares based on the combined perceptions of investors. For non-public companies, setting value is a matter of accepted practice.

58. Investment bankers value companies for purposes of selling a controlling interest by discounting projected future cash flows at a discount rate that reflects the probability that the cash flows will be realized (the "risk"). The higher the certainty of realising the projected cash flow, the lower the discount rate and the higher the present value of the business. Investment bankers use a variety of techniques to estimate value. Although the techniques vary, all are aimed at estimating future profits and cash flow and the level of risk. However, the best test of the value of a company is the price that an informed buyer and informed seller agree on in an arm's-length sales negotiation. The agreed price will reflect the best possible measure of earnings potential of the business.

59. The benefit of a subsidy does not and cannot "pass through" to the buyer in an arm's-length sale at fair market value, as we have seen from the examples above. For the benefit of the grants to Firm A to "pass through" to the new buyer and thus not to be imbedded in the purchase price, it would be necessary for our buyer to purchase Firm A at *less than* the market value of the company - if, for example, the state were to set the selling price of the business on a basis other than market value. Only if the buyer pays less than market value would the benefit of the previous financial contribution "travel" to the buyer. However, this cannot occur in an arm's-length negotiation and sale at fair market value. There, buyer and seller are properly focused on the earnings potential and market replacement value of both the equipment and the work force.

60. If a company is purchased at arm's length and for fair value, there is no economic basis for claiming that the buyer, or the business or productive unit purchased, receives a "benefit" by virtue of the past financial assistance that the seller received. To convey benefit, the seller would effectively have had to sacrifice income by agreeing to a price lower than fair market value.

61. Therefore, the proper economic inquiry in consideration of whether benefit or advantage has "passed through" to a buyer should be the degree to which the authorities consider that "market value" was paid. Such considerations include the fairness and transparency of the negotiation and sales process and the adequacy of value received for the company based on commercially meaningful criteria.

62. The European Communities note that the valuation techniques set forth above are generally accepted practice in privatization and other business transactions. Indeed, the United States Government employed these same valuation methods in its recent privatization of the formerly government-owned US Enrichment Corporation ("USEC"). USEC is the leading US company in the field of transforming natural uranium into enriched uranium fuel for nuclear reactors to produce electricity. Until 1998, the US Government owned USEC, which enriched uranium for both commercial reactors and military uses. USEC and its predecessors were created and nurtured by subsidies amounting to billions of dollars over more than 50 years.

63. In authorising the USEC privatization, the US Congress articulated a single overriding principle - that the US Treasury obtain fair market value for this government-owned firm, with that price defined by the US Congress as the "the net present value of the company".[59]

64. The US Treasury met this requirement through an initial public offering of USEC shares.[60] The valuation of the firm is useful in validating the merit of the

[59] 42 U.S.C. 2297(d)(1); Pub. Law 102-486, §§ 1502(a)(1), (c)(2).

[60] As JP Morgan informed the Congress, "[t]he IPO sales process is a well-established mechanism, which, over a long period of time, has proven successful at ensuring that both buyers and sellers receive a fair price, given the underlying supply and demand for a Corporation's securities". Privatization of the US Enrichment Corporation: *Hearing on Serial 104-8 before the Subcommittee on Energy and Power of the House Committee on Commerce* (104th Congress, 1st Session) 61 (Statement of JP Morgan).

economic principles discussed above. The valuation was conducted by JP Morgan, as financial advisers to USEC. JP Morgan was asked to provide the US Congress with its independent valuation of the likely proceeds from such a public sale, before Congress would agree to allow the US Government to sell the shares in USEC. JP Morgan informed the Congress that USEC, which had received US Government benefits for decades, could be valued using the two industry standard methods for such valuations - estimating the net present value of USEC's projected future cash flows and analysing the company's financial performance versus comparable, publicly traded firms. As JP Morgan informed the US Congress:

> Our net present value calculations involved developing an independent assessment of the future financial performance of USEC and discounting the resulting free cash flow at an appropriate rate, reflecting investors required rates of return for a business with the risk profile of USEC. ... In developing our forecast of USEC's future cash flows, JP Morgan performed extensive due diligence on all aspects of USEC's business and finances. ... The basis for an appropriate discount rate is a cost of capital analysis performed to estimate the cost of both debt and equity for USEC. ...
>
> To confirm the net present value calculations outlined above, we also estimated USEC's value using a comparable trading multiples analysis. This technique involved utilizing the key financial valuation multiples of publicly-traded companies that we considered comparable to USEC. This involved determining the appropriate ranges of Price-to-Cash Flow multiples that are applicable to USEC. ... [T]he comparable trading multiples technique will be the most important valuation technique in any public offering of USEC's stock.[61]

65. JP Morgan analysed the value of USEC entirely without regard to the substantial government benefits previously bestowed upon the state-owned firm, including benefits immediately before privatization. If JP Morgan had considered these benefits relevant to valuing the company, it would have discussed them in their valuation analysis, and prospective investors would have raised the issue. This point is especially important for USEC, which is a major exporter of enriched uranium around the world and would, if other WTO Members were to apply the US practice, be potentially vulnerable to countervailing duty actions.

66. It is therefore plain as a matter of marketplace reality that there exist generally accepted methods for valuation of business concerns and that a buyer purchasing a firm valued pursuant to these methods will be paying a fair market price. Whatever the past sources of a company's value, a buyer of that firm will enjoy no benefit if the buyer has purchased the company for fair market value as a result of a transparent and arm's-length privatization transaction.

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[61] *Hearing on Serial 104-8 before the Subcommittee on Energy and Power of the House Committee on Commerce* (104th Congress, 1st Session) at 60.

67. We now turn to the application of these principles in the context of the *British Steel* cases that are the subject of this dispute.

B. The British Steel Privatization

68. In this Section, the European Communities provide the Panel with argument regarding the arm's-length market privatization of BSC. In particular, we wish to address the irrationality of the US Department of Commerce's practice as applied in the BSC privatization. The DOC practice - while purporting somehow to measure the amount of "subsidies" that "passed through" in a privatization - lacks rational basis and produces wholly arbitrary results.[62]

69. As set forth previously, in attempting to determine that previous subsidies "pass through" in a privatization, the DOC purports to determine the portion of the privatized company's purchase price that is attributable to prior subsidies. DOC undertakes this apportionment by dividing the nominal value of the privatized company's subsidies by its net worth in the years preceding privatization and then averaging the resulting ratios to compute a factor referred to as the "gamma". Without any support from basic principles of economics, finance, accounting or accepted business practice, DOC has declared that its self-derived "gamma" reasonably represents the ratio of past subsidies to the overall value of the business. According to DOC, when the gamma factor is multiplied by the cash portion of the purchase price, the result is the amount of subsidies that remain with the seller in the privatization. Consistent with its apparent intent, this method seems unavoidably to find that the majority of subsidies "pass through" to the purchaser.

70. DOC concluded, after thorough verification of relevant company and UK Government data, that BSC was privatized at an arm's-length, fair market price. Yet the DOC determined that only a small part of the subsidies received by BSC were left behind in the company's privatization. In other words, the purchase price of BSC would have to have been many times higher than its fair market value for DOC to determine that subsidies did not "pass through" to British Steel/UES. The additional payment over and above the market value of BSC would have been far in excess of the entire residual value of subsidies the DOC itself claimed still existed at the time of privatization. On its face, such an outcome is absurd and cannot be sustained.

71. The details of the British Steel case are as follows. Under the DOC methodology set forth above, DOC found that BSC's "gamma" in 1988 - the year of

[62] There are a number of fatal flaws in the DOC subsidies "methodology" which produce results that are arbitrary and irrational. First, as a fundamental matter, DOC takes no account of an arm's-length fair market value transaction, considering its impact on the conferral of benefit "irrelevant". Other such flaws include, solely by way of example, (i) DOC's simplistic assumption that the "purchase price" of a company includes only cash paid, but not liabilities assumed (thus, "passing through" even more subsidies) and (ii) basing the so-called "gamma" calculation on equity, thus forcing gamma to vary depending on a company's degree of financial leverage (the mix of debt and equity) - which, needless to say, is unrelated to subsidy. These irrationalities are detailed in a simple example provided hereto as Exhibit EC-3.

the company's privatization - was 0.46. At the same time, DOC recognized that the sales price of the company was £2,500 million. Accordingly, DOC deemed British Steel plc, the private company, deserving of a "credit" of £1,150 million (0.46 x £2,500 million) against the unamortized amount of pre-privatization subsidies. The £1,150 million credit was deemed to reduce the amount of the unamortized subsidies allegedly passed through to the buyer.

72. Again using the actual example of British Steel, it is plain that under the DOC methodology, in order for the fair market sale of BSC to have fully eliminated the alleged pass-through of benefits conferred to that company, the purchase price in the 1988 privatization would have had to have been much greater than its market value to extinguish all subsidies.

73. There is no rational basis for an approach that requires such disparity between the amount of the unamortized subsidies (*i.e.*, the present value of the future benefits from past subsidies to a prior government-owned firm) and the value that unrelated purchasers are willing to pay for that company in a market value sales transaction.

74. The European Communities thus respectfully submit that the US approach is fatally flawed. This flaw is caused by the United States' reluctance to conform its countervailing duty practice to US ASCM obligations. We now turn to the procedural posture of this dispute and then to the requirements of the ASCM in order to demonstrate that the ASCM mandates that countervailing duties may not be imposed in circumstances where, as here, British Steel plc received no benefit from any financial contribution provided to BSC prior to that company's arm's-length market value privatization.

IV. PROCEDURE

75. The US practices regarding the treatment of pre-privatization subsidies was the subject of a GATT 1947 dispute settlement panel between the United States and the European Communities in 1993.[63] The panel's report, adoption of which was blocked by the United States, is provided as Exhibit EC-9.

76. As a result of the continuing application by the United States of its illegal methodology during reviews conducted after the entry into force of the ASCM, the European Communities requested consultations with the United States on 12 June 1998 (Exhibit EC-10).[64]

77. The Consultations were held on 29 July 1998 in Geneva but did not lead to a satisfactory resolution of the matter.

[63] *United States - Imposition of Countervailing Duties in Certain Lead and Bismuth Carbon Steel Products Originating in France, Germany and the United Kingdom*, Report of the Panel (1994) (unadopted).

[64] Document WT/DS138/1.

78. Accordingly, the European Communities requested the establishment of a Panel on 14 January 1999 in a letter to the Chairman of the Dispute Settlement Body (Exhibit EC-11).[65]

79. At its meeting on 17 February 1999 the Dispute Settlement Body (DSB) established the present Panel. The terms of reference, as contained in Exhibit EC-12, are the following:

> To examine, in light of the relevant provisions of the covered agreements cited by the European Communities in document WT/DS138/3 and WT/DS138/3/Corr. 1, the matter referred to the DSB by the European Communities in that document and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements.

80. Brazil and Mexico have reserved their rights as third parties to the dispute.

V. LEGAL ARGUMENTS

81. After providing general comments on the object and purpose of the ASCM which are relevant to this dispute (Section A), the European Communities establish below two distinct violations of the ASCM. First, as demonstrated in Section B, the United States violates Article 10 ASCM in conjunction with Articles 19, 1 and 14 ASCM by imposing countervailing duties on the imports of privately-owned companies without first examining or establishing whether there exists any subsidy relating to those imports. Second, the United States also violates Article 19.4 ASCM by imposing duties in excess of the amount of any subsidy found to exist, calculated per unit of the subject merchandise (Section C). Following presentation of these arguments, the European Communities illustrate their case by applying the requirements of the ASCM to the case of British Steel/UES (Section D).

82. The EC legal argument may be summarized as follows: Article 10 ASCM requires that a WTO Member take "all necessary steps" to ensure that countervailing duties are imposed by its authorities only in conformity with the terms of the ASCM. Most fundamentally, these include the requirement of Article 19 ASCM that countervailing duties be assessed only if a subsidy exists within the meaning of the Agreement. Article 1 ASCM limits "subsidy" to those instances in which a government has made a "financial contribution" and a "benefit" is thereby conferred. Consistent with the context, object, and purpose of the Agreement, countervailing duties may not be imposed in other circumstances, and such duties, when authorized, may not be in excess of the amount needed to "offset" any subsidy found to exist, under the terms of Article 19.4 ASCM. The extent of a "benefit" conferred, if any, is determined by reference to market benchmarks, as required by ASCM Article 14. Without receipt of advantage by comparison to that market benchmark, no "benefit" exists. A private purchaser of

[65] Document WT/DS138/3 and WT/DS138/3/Corr.1

productive assets at fair market value obtains no "benefit" by virtue of any prior financial contribution by a government to the former owner. By operation of basic economic principles, the arm's-length market price includes the residual value of any prior financial contributions and ensures that the purchaser will enjoy no advantage that may have accrued to the former owner prior to the purchase. As such, the purchaser - *i.e.*, the company now manufacturing, producing or exporting the merchandise under investigation - enjoys no "benefit" from any prior government funding to another unrelated party and has received no subsidy. Therefore, imposing countervailing duties under such circumstances violates the ASCM.

83. In the next Section, the European Communities examine the purposes of countervailing duties, demonstrating that, pursuant to the ASCM and Article VI of GATT 1994, such duties are designed to offset any advantage enjoyed by imported merchandise, but to go no further, as the United States has done in the cases in dispute before this Panel.

A. The Object and Purpose of the ASCM Establish that Countervailing Duties May Offset a Subsidy, But May Go No Further

84. The general rules for interpretation of international treaty obligations are set forth in Article 31 of the Vienna Convention on the Law of Treaties ("Vienna Convention"). Article 31.1 thereof provides, in relevant part, that "[a] treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given the terms of the treaty in their context and in the light of its object and purpose".

85. In the present dispute it is particularly important to bear in mind the structure of the ASCM as context for the provisions to be examined, as well as the object and purpose of countervailing duties as set forth in the ASCM. Therefore, the European Communities will first examine the context of the ASCM and, in particular, the object and purpose of countervailing duties prior to considering relevant legal provisions in greater detail.

86. The introductory provision of Chapter V of the ASCM on countervailing duties is Article 10 ASCM, which provides:

> Members shall take all necessary steps to ensure that the imposition of a countervailing duty on any product of the territory of any Member imported into the territory of another Member is in accordance with the provisions of Article VI of GATT 1994 and the terms of this Agreement. Countervailing duties may only be imposed pursuant to investigations initiated and conducted in accordance with the provisions of this Agreement and the Agreement on Agriculture.

87. The purpose of countervailing duties is made plain by footnote 36 to Article 10 ASCM, which provides:

> The term "countervailing duty" shall be understood to mean a special duty levied for the purpose of offsetting any subsidy bestowed directly or indirectly on the manufacture, production or export of

> any merchandise, as provided for in paragraph 3 of Article VI of the GATT 1994.

88. Article 10 ASCM incorporates into the ASCM the terms of Article VI of the GATT 1994. Article VI of the GATT 1994 provides, in pertinent part:

> The term "countervailing duty" shall be understood to mean a special duty levied for the purpose of offsetting any bounty or subsidy bestowed, directly or indirectly, upon the manufacture, production or export of any merchandise.

89. The plain language of these provisions makes clear that under the ASCM countervailing duties are "special" duties which may be assessed on imported merchandise "*for the purpose of offsetting* any subsidy bestowed" on such merchandise.[66] The ordinary meaning of "offset" is clear: "[t]o set off as an equivalent against something else; to balance by something on the other side or of contrary nature".[67] The concept is further illustrated by the French text of Article 10, which provides that countervailing duties are designed to "*neutralis*er *toute subvention accordée*".[68]

90. The terms of the ASCM and of Article VI of GATT 1994 strike a careful and necessary balance. They underscore that a Member may impose a countervailing duty that offsets (or "neutralizes") a subsidy, but may not go further. A Member may not impose such duties to more than offset a subsidy.

91. While delineating appropriate conditions for the imposition of countervailing duties, Article VI of the GATT 1994, as set forth above, also expressly provides that "no countervailing duty shall be levied ... in excess of an amount equal to the ... subsidy determined to have been granted".[69] Article VI confirms the interpretation that the imposition of a countervailing duty must be a *measured* response, rationally related to the subsidy conferring advantage to the manufacturer and/or exporter of the relevant product and imposed only after such a subsidy is first found to exist.

92. Article 19.4 ASCM makes clear that this means that the amount of the countervailing duty may not be "in excess of the amount of subsidy found to exist, *calculated in terms of subsidization per unit of the subsidized and exported product"*.

93. It is therefore well established by the terms of the ASCM that when countervailing duties are assessed in excess of an actual benefit conferred, they cease to "offset", and rather themselves are distortive. Countervailing measures in "excess" of the subsidy enjoyed calculated in terms of subsidization per unit of the subsidized and exported product contravene the ASCM. It is self-evident that

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[66] (Emphasis added).

[67] The Oxford English Dictionary, Oxford University Press (1971).

[68] This fundamental principle has been recognized in the United States for over two decades. According to the United States Supreme Court, the purpose of the US countervailing duty law is "to *offset the unfair competitive advantage* that foreign producers would otherwise enjoy from export subsidies paid by their governments". *Zenith Radio Corp. v. United States*, 437 US 443 (1978) (emphasis added).

[69] Article VI:3 GATT 1994. See also Article 19.4 ASCM, discussed below.

imposing countervailing measures in the *absence* of a subsidy violates the ASCM.[70]

94. Thus, the ASCM provides that WTO Members may redress the trade-distorting advantage of a subsidy by means of an agreed remedy: the imposition of countervailing duties. However the ASCM does not allow Members to impede trade by the imposition of countervailing duties in an excessive or impermissible manner.

95. Therefore, consistent with the Vienna Convention rules of interpretation, the established purpose for assessment of countervailing duties is to offset the advantage afforded imported merchandise by a subsidy bestowed upon the manufacture, production or export of that merchandise. In accordance with this purpose, the conditions which must be fulfilled for countervailing duties to be levied are:

- the existence of a subsidy. The term "subsidy" is defined in Article 1 ASCM as comprising two elements, a financial contribution by a government and a benefit which is thereby conferred. The most important element for the purposes of the present dispute is "benefit", which must be interpreted in accordance with Article 14 ASCM.
- the subsidy must not have been "withdrawn" (Article 19.1 ASCM).
- that "through the effects of the subsidy, the subsidized imports are causing injury". This requirement is found, *inter alia*, in Article 19.1 ASCM but does not appear relevant in the present case and will not be considered further;
- that countervailing duties are calculated "in terms of subsidization per unit of the subsidized and exported product" at a level no more than necessary to offset the subsidy (Article 19.4 ASCM).

96. We now turn to the first of these obligations and show that, by imposing countervailing duties where no subsidy exists, the United States has violated its obligations under Article 10 ASCM to take "all necessary steps" to ensure that such duties are imposed only in accordance with the terms of the ASCM.

[70] Two recent panel reports underscore this point. In *Brazil - Export Financing Programme for Aircraft*, the panel wrote that "the object and purpose of the SCM Agreement is to impose multilateral disciplines on subsidies which distort international trade". *Brazil - Export Financing Programme for Aircraft* ("Brazil – Aircraft"): adopted 20 August 1999, as modified by the Appellate Body Report, WT/DS46/AB/R, DSR 1999:III, 1221, para. 7.26. The *Canada Aircraft* panel noted that "the object and purpose of the SCM Agreement could ... be summarized as the establishment of multilateral disciplines 'on the premise that some forms of government intervention distort international trade, [or] have the potential to distort [international trade]'". *Canada - Measures Affecting the Export of Civilian Aircraft* ("Canada – Aircraft"), WT/DS70/R, adopted 20 August 1999, as upheld by the Appellate Body Report WT/DS70/AB/R, DSR 1999:IV, 1443, para. 9.119.

B. The United States Has Violated Article 10 ASCM by Imposing Countervailing Duties Without Having Established that a Subsidy Exists

1. Introduction

97. In order for a Member's practice to meet the requirements of Article 10, as set forth in Section A above, the Member must take "all necessary steps" to ensure that its imposition of countervailing duties conforms to the requirements of the ASCM. To do otherwise is to fail to comply with the express requirements of Article 10.

98. Pursuant to this requirement, the ASCM clearly mandates that a Member make a threshold determination of the "existence" of a subsidy before examining other ASCM requirements. Such a determination must occur prior to and wholly distinct from later determining the *amount* of a subsidy, for which it is a necessary condition precedent.[71] This determination must be adequately demonstrated and explained.[72]

99. Consistent with the mandate of Article 10 ASCM, the fundamental requirement first to determine that a "subsidy exists" is also found elsewhere in the ASCM, including Articles 19.1 and 19.4, and in Article VI of the GATT 1994. Article 19.1 establishes that a Member may impose countervailing duties only after making "a final determination of the *existence* and amount of a subsidy ..." and "unless the subsidy or subsidies are withdrawn". The fact that a government recovers the residual value of any subsidies that it has granted in the past through a fair market value and arm's length sale of the assets of the previous beneficiary must be one of the means by which the subsidy can be "withdrawn". Article 19.4 ASCM requires that "[n]o countervailing duty shall be levied on any imported product in excess of the amount of the subsidy *found to exist* ... ." (emphasis added). Article VI:3 of the GATT 1994 sets forth the same obligation, requiring that "[n]o countervailing duty shall be levied on any product ... in excess of an amount equal to ... the subsidy *determined to have been granted*. ..." (emphasis added).

100. The necessary premise that a Member must first determine the existence of a subsidy is confirmed in the recent panel report in *Canada - Measures Affecting the Export of Civilian Aircraft*:

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[71] As contextual interpretative support, Article 19.2 ASCM provides that the "decision whether or not to impose a countervailing duty" and the "decision whether the amount of the countervailing duty to be imposed shall be the full amount of the subsidy or less" are left to the discretion of the Member. These distinct decisions may only be made "where all the requirements for imposition have been fulfilled".

[72] See Panel Report *United States - Restrictions on Imports of Cotton and Man-made Fibre Underwear* ("US – Underwear"): WT/DS24/R adopted 25 February 1997 as modified by the Appellate Body Report, WT/DS24/AB/R, DSR 1997:I, 31, para. 745; Report of the Panel *United States - Measure Affecting Imports of Woven Wool Shirts and Blouses from India* ("US – Wool Shirts and Blouses"): WT/DS33/R adopted 23 May 1997, as upheld by the Appellate Body Report, WT/DS33/AB/R, DSR 1997:I, 343,para. 7.26.

> [T]the need to calculate the *value* of a subsidy only arises once the *existence* of the subsidy, and therefore the "*financial contribution*" and "*benefit*", have been established. ... . "[B]enefit" must be established *before* the value of the alleged subsidy may be considered. ...[73]

101. Thus, the terms of the ASCM, interpreted in accordance with their ordinary meaning and read in the context of the object and purpose of countervailing duties as set forth in Articles 10, 19.1, and 19.4, require that Members "take all necessary steps" to demonstrate the *existence* of a subsidy. Consistent with this plain language, this inquiry must occur before a countervailing measure may be imposed. A Member's obligation in this regard cannot and does not end with a determination that an unrelated party at some point in the past received a subsidy. It must be demonstrated as a result of all available evidence that *the party under investigation*, whose goods are the ones subject to an *offsetting* countervailing duty, was the recipient of a subsidy. This means that it must be **demonstrated** (not arbitrarily assumed) that the party under investigation has either received itself a financial contribution and a benefit, or has benefited from a financial contribution to a third party. By the clear terms of the Agreement, calculating the amount or allocation of a "subsidy" may not take place without first establishing its existence.[74]

2. A Member May Find that a "Subsidy" Exists Only When a "Benefit" is Conferred by a "Financial Contribution" Within the Meaning of Article 1 ASCM

102. In order to demonstrate that a "subsidy" exists within the meaning of the ASCM, it is necessary by virtue of Article 1 ASCM to determine that there is a "financial contribution by a government or any public body within the territory of a Member ... and a benefit is thereby conferred".[75]

103. The word "thereby" signifies a causal relationship between the financial contribution and the benefit. The European Communities submit that a "financial contribution" made by a government to a state-owned company cannot causally confer a "benefit" on a privately-owned buyer of assets which once belonged to the state-owned company, where those assets were purchased on an arm's-length basis at fair market value. In such circumstances, any "benefit" that was conferred on the previous owner of those assets remains with the state-owned company. The United States refuses to accept this position, instead "irrebuttably" presuming that a benefit automatically "travels" with the assets and "passes through" to the new owner. The European Communities cannot understand, and the United States has never intelligibly explained, how this magical process occurs.

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[73] Panel Report, *supra*, footnote 70, para. 9.116..
[74] See text relating to the previous footnote.
[75] Article 1.1(a)(1); Article 1.1(b).

104. To examine whether a "benefit" exists according to the terms of Article 1.1(b) requires an examination of what constitutes a "benefit" under the ASCM, and who is the recipient of any benefit allegedly "conferred".

a. The Existence of a "Benefit", if any, is Determined by Reference to Market Benchmarks Under the ASCM

105. The ordinary meaning of the term "benefit" as used in Article 1.1(b) ASCM is "advantage".[76] A "benefit" to a person within the meaning of Article 1.1 does not exist unless "advantage" is conferred on that person as the result of a government "financial contribution".[77]

106. Article 14 ASCM provides relevant context for the interpretation of Article 1.1 (b), particularly in assessing whether such an advantage is enjoyed as the result of a financial contribution. It prescribes the methods by which an investigating authority shall calculate the "benefit to the recipient conferred", if any, as a result of a government financial contribution. Article 14 therefore establishes that this calculation is necessarily bounded by assessing whether a *commercially meaningful* advantage has been given to the firm under investigation. This analysis requires a comparison of the terms of the financial contribution under consideration with those that would have prevailed in the marketplace.

107. Specifically, Article 14 provides that a variety of financial contributions by a government "shall not be considered as conferring a benefit" unless they are inconsistent with commercially meaningful benchmarks:

- Article 14(a): "inconsistent with the usual investment practice ... *of private investors*";
- Article 14(b): "a difference between the amount that the firm ... pays on the government loan and the amount the firm would pay on *a comparable commercial loan* which the firm could actually obtain *on the market*";
- Article 14(c): "a difference between the amount that the firm receiving the guarantee pays on a loan guaranteed by the government and the amount that the firm would pay on a *comparable commercial loan*"; and
- Article 14(d): "the adequacy of remuneration shall be determined in relation to *prevailing market conditions*". (Emphasis added.)

108. The requirement that benefit be assessed by reference to the market is delineated clearly in the recent panel report in *Canada Aircraft*:

> In our view, *the only logical basis* for determining the position the recipient would have been in absent the financial contribution *is*

[76] See The Oxford English Dictionary, Oxford University Press (1971). See also Blacks Law Dictionary, West Publishing Co. (6th Ed. 1990) ("Advantage; profit; fruit; gain; interest").

[77] This definition was recently adopted in the *Canada Aircraft* panel report, which noted that "[i]n order to determine whether a financial contribution ... confers a 'benefit', i.e., an advantage, it is necessary to determine whether the financial contribution places the recipient in a *more advantageous position than would have been the case but for the financial contribution*". Panel Report *Canada - Aircraft*, *supra*, footnote 70, para. 9.112 (emphasis added).

> *the market*. Accordingly, a financial contribution will only confer a "benefit", *i.e.*, an advantage, if it is provided on terms that are more advantageous than those that would have been available to the recipient on the market.[78]

109. Further support for use of the market as the appropriate yardstick for measurement of benefit is found in the recent panel report in *Brazil - Export Financing Programme for Aircraft*, which underscores that in assessing the existence of a benefit:

> [O]ne should examine objective benchmarks ... involving a comparison of the terms of the financial contribution to a *market benchmark* reflecting the terms under which the beneficiary of the financial contribution would be operating in the absence of the government financial contribution.[79]

110. Accordingly, where a privately-owned company has purchased a company at fair market value in an arm's-length transaction, there can be no benefit conferred on the purchaser within the meaning of the ASCM. A purchaser of a formerly state-owned assets at market value is not in any way put in a more advantageous position in comparison to the market. Indeed, as explained in Section II above, a rational purchaser is indifferent between purchasing a firm which previously received financial contributions from a government and one which did not if the two firms have equivalent market value. An advantage would be granted to a buyer only if it were to purchase the firm at *less* than fair market value as the result of a seller favouring one of the bidders unfairly. In order to determine that the new privately-owned company has obtained a "benefit", a Member's investigating authorities must prove that the current producer/exporter has obtained the assets under circumstances inconsistent with commercial considerations.

b. A Benefit Must Be Conferred on the Company Whose Imports Are To Be Countervailed Under the ASCM

111. The European Communities submit that when the ASCM is interpreted in accordance with Article 31.1 of the Vienna Convention, a "benefit", as the term is employed in the ASCM, must be conferred on the party whose imports may be countervailed.

112. Article 10 makes clear that countervailing duties are for the purpose of *offsetting* subsidies "determined to have been granted"[80] to "the *manufacture, production or export of any merchandise*".[81] The merchandise manufactured, produced or exported must be that of the party upon whom a Member seeks to

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[78] *Canada Aircraft* panel report at para. 9.112 (emphasis added).

[79] Panel Report, *supra*, footnote 70, para. 7.24 (emphasis added). The panel emphasized that Article 14 ASCM requires use of the market benchmark in all countervailing duty cases other than those involving a presumption of serious prejudice under Article 6.1(a) ASCM.

[80] Article VI:3 GATT 1994.

[81] Article 10, footnote 36 (emphasis added).

impose offsetting duties, or those duties will have no rational relationship to the very "benefit" they are meant to offset.

113. Similarly, Article 19.1 establishes that, when undertaking the required examination of "injury", WTO Members shall examine whether "subsidized imports" are the cause of the injury. Such imports must, self-evidently, be the products under investigation, and it is only the firm manufacturing, producing, or exporting such products that is subject to the CVD inquiry. These provisions would make little sense if the examination of merchandise under investigation were designed to focus on an unrelated company which does not produce the relevant merchandise.[82]

114. This position is supported by the available pre-WTO case law. In United States - *Countervailing Duties on Fresh, Chilled and Frozen Pork from Canada,* the panel adopted an equivalent approach finding that the United States could not irrebuttably presume that a subsidy conferred on pig farmers necessarily benefited pork, the product under investigation.[83] Similarly, and even more pertinently for the present case, the panel in United States - *Imposition of Countervailing Duties in Certain Lead and Bismuth Carbon Steel Products Originating in France, Germany and the United Kingdom*[84] considered that

> the fundamental legal requirement in light of which the consistency of this "pass through" analysis with the Agreement had to be examined was the rule, reflected *inter alia* in Article 1, footnote 4, that a determination of the existence of subsidy bestowed on the production of the merchandise was a necessary condition for the imposition of a countervailing duty on the importation of that merchandise.[85]

(The footnote 4 to Article 1, to which that panel was referring was that in the Tokyo Round Subsidies Agreement which corresponds to footnote 36 of Article 10 of the ASCM referred to in Section A above.)

115. The panel in that case was following exactly t he approach advocated by the European Communities - that a subsidy must be shown to have been bestowed on the production of the merchandise subject to the countervailing duty action. It necessarily follows from this that a subsidy conferred on a person that is not producing the goods subject to the proceeding cannot be *deemed* to be bestowed on those goods without any demonstration, as was and still is done by the United States.

116. If, as the United States has set forth in the countervailing duty determinations before this Panel, Article 1.1(b) requires no finding of any benefit to the company whose products are under investigation even when it is clear, as here,

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[82] We note that the recipient of the relevant financial contributions, BSC, has not produced steel since 1986.

[83] *United States - Countervailing Duties on Fresh, Chilled and Frozen Pork from Canada*: Report of the Panel, DS7/R-B I SD 38S/30 (11 July 1991) at paras. 4.6 and 4.9.

[84] Cited in Section III above.

[85] See para. 420.

that advantage was bestowed only on an unrelated prior owner, then the ASCM would have to be read to endorse countervailing duties on companies that no longer produce the subject "merchandise" or "imports". Consistent with the object and purpose of countervailing duties as set forth, *inter alia*, in Article 10, this cannot be a proper interpretation of the ASCM or of GATT 1994.

3. Conclusion

117. In sum, the benefit requirement of Article 1.1(b) mandates, as a prerequisite to imposition of countervailing duties, that government authorities determine that a benefit is conferred that puts *a company under investigation* and its products "in a more advantageous position than would have been the case *but for* the financial contribution".[86] Absent an advantage resulting from a financial contribution, there is no "benefit" conferred and therefore no "subsidy" that may be countervailed. Imposing countervailing duties where no subsidy exists violates the terms of Article 10 ASCM as read in conjunction with Articles 19, 1, and 14 thereof.

118. In the next Section, the European Communities demonstrate that the US practice also violates Article 19.4 ASCM.

C. The United States Violates Article 19.4 ASCM by Imposing Countervailing Duties in Excess of the Amount of Subsidy

119. As the European Communities have set forth above, it is impermissible under the ASCM to deem an unrelated purchaser of a formerly state-owned enterprise to have received a subsidy solely on the basis that subsidies previously bestowed upon that enterprise automatically "pass through" to the purchaser, notwithstanding the fact that the enterprise was sold at arm's length for fair market value. However, even if the US assumption of the existence of a subsidy were permissible, the amount of any subsidy calculated must necessarily be zero when measured against the requisite market benchmark. As a result, the United States violates Article 19.4 ASCM when it imposes countervailing duties on the products of such an unrelated private purchaser with respect to pre-privatization subsidies.

120. Article 19.4 of the ASCM requires that:

> No countervailing duty shall be levied on any imported product *in excess* of the amount of the subsidy found to exist, calculated in terms of subsidization per unit of the subsidized and exported product. (Emphasis added).

121. The requirement of Article 19.4 is a re-exposition of the terms of Article VI of the GATT 1994 which, in pertinent part, provides:

> No countervailing duty shall be levied on any product of the territory of any contracting party ... *in excess* of an amount equal to the

[86] Panel Report *Canada - Aircraft*, *supra*, footnote 70, para. 9.112 (emphasis added).

> estimated bounty or subsidy determined to have been granted, directly or indirectly, on the manufacture, production or export of such product in the country of origin or exportation ... . (Emphasis added).

122. The requirement that a Member not impose countervailing duties in amounts above what is strictly necessary to offset a subsidy is also set forth in Article 21.1 ASCM, which provides, in relevant part, that "a countervailing duty shall remain in force *only as long as and to the extent necessary to counteract subsidisation* ..." (emphasis added).[87] This requirement to eliminate countervailing duties where subsidy no longer exists underscores the required rational relationship between the amount of a subsidy and the level of countervailing measures. Similarly, Article 21.2 ASCM specifically calls on investigating authorities to examine the need for the "continued imposition of the duty". In particular, interested parties shall have the right to request authorities to examine "*whether the continued imposition of the duty is necessary to offset subsidization"* (emphasis added).

123. Further contextual support for this requirement that countervailing duties may not exceed the amount of a subsidy is found in the last words of Article 19.1 ASCM, which provide that a countervailing duty may not be imposed where "the subsidy or subsidies are withdrawn". Clearly, no countervailing duty is needed to neutralize a withdrawn or no longer existing subsidy, and hence any countervailing duty imposed would be in excess of that allowed to offset "subsidy".[88]

124. Thus, in conformity with the context, object, and purpose of the countervailing duty rules, as set forth in Section A above, Article 19.4 and Article VI of GATT 1994, read in conjunction with Article 21.1, 21.2 and 19.1, establish that Members must ensure that trade is not impeded by imposition of countervailing duties at a level more than necessary to offset the benefit enjoyed by such imported merchandise.

125. The European Communities submit that the US privatization practice violates US obligations under Article 19.4 ASCM because the countervailing duties are imposed at levels in excess of those needed to "offset" any subsidy bestowed directly or indirectly upon the manufacture, production or export of subject merchandise.

126. It is self-evident that a requirement that countervailing duties not be in "excess of the amount of the subsidy found to exist" requires a threshold determination of the "amount of the subsidy". Under the terms of Articles 1 and 14 ASCM, and as set forth in Section B above, a determination of the "amount of subsidy" necessarily requires a measurement of the amount of "benefit" conferred. This requires comparing the terms of the financial contribution at issue with those that would have prevailed in the marketplace absent the subsidy. The

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[87] See also Article 21.4 ASCM which applies the evidence requirements of Article 12 ASCM to Article 21 reviews.

[88] It is difficult to conceive of what more a government may do to withdraw a subsidy than to privatize a state-owned entity in a transparent process at arm's length for fair market value.

European Communities would emphasize that this comparison must be made by reference to a market benchmark.[89]

127. Pursuant to the requisite analysis under Article 14 ASCM, the European Communities submit that a private purchaser of a company or productive assets thereof at fair market value obtains no benefit from subsidies granted to the seller. Any benefit stream established for the purposes of allocating the benefit granted **to the previous owner** ceases to apply. Put differently, consistent with the market benchmark established in Article 14 ASCM, the price paid in an arm's-length transaction is equal to the fair market value. Hence, the "amount of the subsidy" is zero, and, self-evidently, there can be no "subsidization per unit" of the product under investigation. However, as the European Communities have shown in Section I.A above, the United States employs an self-derived formula which provides arbitrary and unreasonable results to allocate an amount of subsidy to a purchaser of assets and thus to its products exported to the United States.

128. As a result, the United States violates Article 19.4 ASCM when, as here, it imposes and maintains countervailing duties on the products of such private purchasers.

129. We now turn to further examination of the requirements of the ASCM as applied to the facts of the dispute before this Panel.

D. Application to British Steel/UES

130. The central issue in this dispute is whether there exist subsidies to UES, and in turn British Steel plc, from financial contributions made to state-owned BSC, considering that, as the United States has itself found[90], UES purchased the speciality steels division of BSC in an arm's-length transaction at fair market value and further considering that BSC was subsequently privatized at arm's length for fair market value. By the plain terms of the ASCM, no such subsidy exists. Therefore, the imposition and maintenance of countervailing duties on the products of UES and British Steel plc on such basis by the United States is in violation of Articles 10 and 19 of the ASCM, read in conjunction with Articles 1 and 14 thereof.

131. The European Communities acknowledge that a "financial contribution" was made by the UK Government to BSC. The European Communities further acknowledge that such financial contributions benefited BSC in the past and constituted "subsidies" to that firm.[91]

132. The European Communities contend, however, that such prior contributions are not "subsidies" in the cases that form the basis for the dispute before this Panel, because they confer no "benefit" on UES or British Steel plc, the

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[89] See Section IV.B.2(a) above; Panel Report *Canada - Aircraft, supra*, footnote 70, para. 9.112; Panel Report *Brazil - Aircraft, supra*, footnote 70, at para. 7.24.

[90] See footnotes - and accompanying text above.

[91] BSC last produced steel in 1986.

companies whose products are subject to the relevant US CVD determinations and whose imports into the United States are being assessed countervailing duties. Neither of those companies received a financial contribution from the UK Government. Rather, in arm's-length market-based transactions, they simply acquired part (UES) or all (British Steel plc) of another company (BSC) that had previously received a subsidy.

133. The record of the *Leaded Bars* determinations before this Panel makes clear that the United States explicitly and repeatedly has refused to enquire as to whether a benefit, and therefore a "subsidy", was conferred on British Steel plc or UES, much less to demonstrate that such a benefit was actually conferred. Rather, the United States improperly *assumed* such a benefit was conferred by stating that a previous contribution to BSC "passed through" to UES and British Steel plc without demonstrating the "pass through" as an economic reality or explaining the nature of the "pass through" by reference to the ASCM or to any commercial or market benchmark. Then, treating the payment of a fair market price as "irrelevant" to its analysis, the DOC simply applied its self-derived formula in purporting to "allocate" the value of previous financial contributions between BSC, on the one hand, and UES and British Steel plc, on the other.

134. While this approach may be administratively convenient for the United States investigating authorities, the "pass through" methodology and the "irrebuttable presumptions" described in Section I above that it entails are not an acceptable surrogate for adhering to the plain requirements of the ASCM.[92] Allocation of a subsidy is not permissible under the ASCM prior to establishing that a subsidy exists.

135. The United States has never established the existence of an Article 1 "subsidy" to British Steel plc/UES because the economic reality of an arm's-length transaction for fair market value mandates that it *cannot* be established. By definition, a purchase at fair market value necessarily includes the residual value of any remaining subsidies at the time of the sale.

136. Contrary to US obligations to the European Communities under the ASCM, countervailing duties have been levied on UES and, in turn, British Steel plc that go beyond "offsetting" any subsidy bestowed directly or indirectly upon the manufacture, production or export of subject merchandise by those companies.

137. The US *Leaded Bars* determinations violate the United States' Article 10 ASCM obligation to "take all necessary steps" to ensure that countervailing duties are imposed on imported products only in accordance with the requirements of the ASCM. ASCM obligations include the Article 19 requirement to determine that a subsidy "exists" prior to levying a countervailing duty and making that determination by virtue of the Article 1 definition of the term "benefit", as

[92] The United States has claimed that its privatization rules are justified by a desire to ensure that firms do not engage in sham change of ownership transactions in an effort to escape the appropriate application of countervailing duties. See, e.g., *1992 Investigation* at 6240. This argument is irrelevant to the dispute before this Panel, as, by definition, it has no application to *bona fide* arm's length sales at fair market value.

measured by the market standard set forth in Article 14. For these same reasons, the United States has also violated its Article 19.4 ASCM obligation to ensure that countervailing duties not be imposed in excess of the amount of the subsidy found to exist; here, the "amount of the subsidy" pursuant to the Article 14 ASCM market benchmark is plainly zero.

138. By failing to comply with its ASCM obligations in the foregoing respects, the United States has done precisely what a WTO Member may not - it has imposed duties going beyond what is necessary for the purpose of countervailing a "subsidy", as that term is set forth and properly understood in the ASCM, and has maintained these duties following several administrative reviews. The result of these duties has been to distort international trade unfairly and penalize European firms impermissibly.

VI. CONCLUSION

139. For the foregoing reasons, the European Communities respectfully request that the Panel find that by imposing countervailing duties on leaded bar imports from the United Kingdom in the 1995, 1996, and 1997 administrative reviews, the United States has violated:

- ASCM Article 10, as read in conjunction with Articles 19, 1, and 14 ASCM and Article VI of GATT 1994, by imposing countervailing duties where no subsidy exists; and
- ASCM Article 19.4 by levying countervailing duties on imported products in excess of the amount of any subsidy found to exist under the terms of the ASCM.

140. In so doing, and in particular by applying its illegal policy to the exports of leaded bars produced by British Steel/ UES in the UK, the United States has nullified and impaired benefits accruing to the European Communities under the WTO Agreements.

141. The European Communities further request that the Panel recommend that the United States immediately bring its measures into conformity with its WTO obligations.

EXHIBITS

Exhibit EC-1	*Lime from Mexico*; *Preliminary Results of Changed Circumstances Countervailing Duty Administrative Review*, 54 Fed. Reg. 1753, 1754-55 (17 January 1989) ["*Lime from Mexico*"].
Exhibit EC-2	Relevant Sections of the "General Issues Appendix", appended to *Final Affirmative Countervailing Duty Determination*; *Certain Steel Products from Austria*, 58 Fed. Reg. 37217 (9 July 1993).
Exhibit EC-3	Sample calculation using the DOC's "privatization methodology".
Exhibit EC-4	*Final Affirmative Countervailing Duty Determination: Certain Hot Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom*, 58 Fed. Reg. 6237 (27 January 1993) ["*1992 Investigation*"].
Exhibit EC-5	*Certain Hot Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom*, 61 Fed. Reg. 58377 (14 November 1996) ["*British Steel plc 1995 Administrative Review*"].
Exhibit EC-6	*Certain Hot Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom*, 62 Fed. Reg. 53306 (14 October 1997) ["*British Steel plc 1996 Administrative Review*"].
Exhibit EC-7	*Certain Hot Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom, 7*2 Fed. Reg. 18367 (15 April 1998) ["*British Steel plc 1997 Administrative Review*"].
Exhibit EC-8	*Final Affirmative Countervailing Duty Determination*; *Certain Steel Products from the United Kingdom*, 58 Fed. Reg. 37393 (9 July 1993).
Exhibit EC-9	United States - *Imposition of Countervailing Duties in Certain Lead and Bismuth Carbon Steel Products Originating in France, Germany and the United Kingdom*, Report of the Panel (1994) (unadopted).
Exhibit EC-10	Document WT/DS138/1 (Request for Consultations).
Exhibit EC-11	Document WT/DS138/3 and WT/DS138/3 Corr 1. (Request for the Establishment of the Panel).
Exhibit EC-12	Document WT/DS138/4 (Constitution of the Panel).

EXHIBIT EC-1

Lime from Mexico; *Preliminary Results of Changed Circumstances Countervailing Duty Administrative Review*, 54 Fed. Reg. 1753, 1754-55 (17 January 1989) ["*Lime from Mexico*"].

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Relevant "Sections of the General Issues Appendix", appended to *Final Affirmative Countervailing Duty Determination*; *Certain Steel Products from Austria*, 58 Fed. Reg. 37217 (9 July 1993).

EXHIBIT EC-3

Sample calculation using the DOC's "privatization methodology"

EXHIBIT EC-4

Final Affirmative Countervailing Duty Determination: *Certain Hot Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom*, 58 Fed. Reg. 6237 (27 January 1993).

["*1992 Investigation*"]

EXHIBIT EC-5

Certain Hot Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom, 61 Fed. Reg. 58377 (14 November 1996)

["*British Steel plc 1995 Administrative Review* "].

EXHIBIT EC-6

Certain Hot Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom, 62 Fed. Reg. 53306 (14 October 1997)

[*"British Steel plc 1996 Administrative Review"*].

EXHIBIT EC-7

Certain Hot Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom, 72 Fed. Reg. 18367 (15 April 1998)

[*"British Steel plc 1997 Administrative Review"*].

EXHIBIT EC-8

Final Affirmative Countervailing Duty Determination: *Certain Steel Products from the United Kingdom*, 58 Fed. Reg. 37393 (9 July 1993).

EXHIBIT EC-9

United States - *Imposition of Countervailing Duties in Certain Lead and Bismuth Carbon Steel Products Originating in France, Germany and the United Kingdom*, Report of the Panel (1994) (unadopted).

EXHIBIT EC-10

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EXHIBIT EC-12

Document WT/DS138/4 (Constitution of the Panel).

ATTACHMENT 1.2

ORAL STATEMENT AND CONCLUDING STATEMENT OF THE EUROPEAN COMMUNITIES DURING THE FIRST SUBSTANTIVE MEETING WITH THE PANEL

(Geneva, 15 June 1999)

2. Introduction

1. Mr. Chairman, distinguished Members of the Panel. The Community wishes to thank you for taking on this task. It also wishes to thank the WTO Secretarial Staff.

2. The EC's statement will briefly highlight the main points which were made in the EC's First Written Submission. However, the EC would also like to take this opportunity to offer some preliminary remarks regarding the US First Written Submission, while reserving the right to provide more detailed comments in the EC's Second Written Submission.

3. The Community will not repeat in detail the arguments which it has already made in writing. If the Panel has questions on the content of these arguments, the Community would be pleased to respond to those questions either orally today, or otherwise - as soon as possible - in writing.

4. The EC's presentation today will be structured as follows :

5. First, the EC will explain the fundamental economic logic of its arguments, which are strongly supported by basic economic principles. The EC will also set out why the US practice, if applied by all WTO Members, constitutes a serious risk to international economic order and the WTO system.

6. Second, the EC will set out briefly why the US has violated Articles 10, 19:1 and 19:4 Subsidies Agreement.

7. Then - turning to the US legal argumentation - the EC will address selected serious flaws and misstatements in the US First Written Submission, including:

- First, the inappropriate reliance by the US on rulings by its own *national courts*.
- Second, the relevant *standard of review* for this dispute, which cannot be based on Article 17:6 Anti Dumping Agreement.
- Third, the false characterization of the EC position by the US, which has incorrectly asserted that the EC relies on a so-called "*use and effects*" test.
- Fourth, the inaccurate assumption by the US that the Subsidies Agreement allows it to make *irrebuttable presumptions* that the benefits of an subsidy to a state-owned company flow automatically to the new owners of productive assets after an arm's length fair market value privatization, without any demonstration of any benefit being received by the privately owned company. The Subsidies Agreement does not allow for such an extreme position.

- Fifth, the US assertion that a "subsidy recipient" can somehow be productive assets themselves. This is not correct: the only beneficiary of the subsidy can be the owner of the productive assets, i.e. a "*legal person*".
- Sixth, the fact that the US claims that the object and purpose of the Subsidies Agreement and countervailing duties is to "*deter*" subsidisation. This punishment theory of countervailing duties, which serves, in part, as the US justification for imposing countervailing duties on companies for which it has never demonstrated even the simple receipt of a benefit, is bluntly wrong: the Subsidies Agreement makes clear that the exclusive purpose of CVDs is to "offset" subsidies.

8. Finally, the EC will briefly address the US reliance on Article 27:13 Subsidies Agreement as well as the irrelevance of EC State Aid rules.

3. Economic considerations

9. In the case before this Panel, the US has irrebuttably presumed that the private company which purchased specialty steel assets *at arm's length for fair market value* somehow benefits from subsidies provided to the former state-owned company. As a matter of basic economics, this is untenable. In defense of its position, the US simply argues that it is entitled under the Subsidies Agreement to draw this conclusion in the face of all available evidence, by refusing, as a matter of state policy, to even consider the relevant economic facts prior to imposing countervailing duties which are meant, under the explicit text of the Subsidies Agreement, to "offset" concrete benefits. These facts lead to the inevitable conclusion that no benefit to the new owner of productive assets survives.

10. Both the EC and Brazil have already offered the Panel extensive written comments and examples on why this US practice ignores the economic realities of arm's-length privatizations. When a private buyer purchases the productive assets of a company in an arm's-length transaction at market value, the price paid necessarily values and incorporates within the transaction any subsidy previously conferred. If the subsidy increases the value of the company, so will it increase the price that the purchaser must pay in a fair market value transaction. The payment of a market price thus necessarily precludes the notion that any "benefit" would have "passed through" to this new private owner as a basic matter of economics. Simply put, markets value companies efficiently, including any remaining value of prior government financial contributions. This is not open to serious economic dispute and the US offers none - the fair market value purchaser receives *no* benefit from a subsidy provided to a former state owned enterprise in such a situation.

11. It is this economic logic on which the EC argumentation is based. It is this economic logic which is supported by Brazil and Mexico, the Third Parties to this dispute. It is this economic logic which the US itself applies in other areas of its countervailing duty practice and which it earlier applied in privatization treatment prior to the institution of its current impermissible practice in 1993. It is this

economic logic which is confirmed by a noted international economist in the US who has directly addressed the issue.

12. Professor Richard N. Cooper, Professor of International Economics at Harvard University and former Under Secretary of State for Economic Affairs in the United States has written a short analysis for the US "Consumers for World Trade." They recently published the text of his analysis on the Internet and the EC submits this paper today as Exhibit EC-13. Let me quote from Professor Cooper's paper :

> "[t]he DOC deems the issue of whether or not the sale of a state-owned company was for fair market value irrelevant to its calculation of CVD's on the merchandise of the now-privatized company. From the perspective of analysing whether any benefit is enjoyed by the privatized company, however, *this inquiry is the most fundamental issue*. As stated above, competitive bidders will make a full assessment of the expected economic value of the firm, and will bid accordingly. *Thus they will pay in full for any economic benefit remaining with the firm*. If a bidder failed to do so, he would leave value on the table and lose the bid to another bidder who took such value into his bid[93] ."

13. Therefore, when determining whether or not a benefit has "passed through" to the buyer, the conditions surrounding the purchasing price should be examined, so as to verify whether or not a fair market value was paid. In other words, apart from simply noting the level of the purchasing price, as USDOC does under its methodology, a separate examination is needed if a privatization takes place. USDOC conducts what it terms an "investigation" when it applies its contested methodology, but claims it is allowed to refuse to examine the very conditions of the purchase, which is in view of the EC, Mexico, Brazil, as well as Professor Cooper, a fatal error, and which is the main reason why we are here today.

14. Interestingly, when evaluating upstream subsidies, the US considers the fair market price quite relevant. It examines and verifies whether or not a fair market price is paid.[94] For example, when meat would be purchased by pork producers from subsidized swine producers (as in the *Pork* case[95]), the US would now determine whether the swine producers would have sold their raw material for a price which was lower than the fair market price, thereby " passing on" a benefit to the pork producers.

15. However, the US explicitly refuses any examination or analysis of the conditions of a sale in the framework of privatization. According to the US such analysis is not relevant. It says so clearly in the General Issues Appendix :

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[93] Emphasis added.

[94] See Section 771A of the URAA and Section 351.523 of the final USDOC CVD regulations which govern treatment of upstream subsidies by the US in CVD investigations.

[95] After the US lost the Canada Pork Case *(United States - Countervailing Duties on Fresh, Chilled and Frozen Pork From Canada*, Report by the Panel adopted on 11 July 1991, DS7/R, BISD 38S/30), the US was obliged to change its policy.

> "Given the Departments' methodology […] *concerns regarding whether or not the sale* […] *was at fair market price are irrelevant*."[96]

16. As demonstrated before, this position is untenable, arbitrary and economically irrational. Therefore, this refusal to examine whether or not the sale of a government-owned company was executed for a fair market price cannot be considered "reasonable", as USDOC claims in its pre-Subsidies Agreement General Issues Appendix that it continues to apply to this day.[97]

4. US practice has negative effect on privatization efforts throughout the world

17. In addition to its serious legal and economic errors, the US approach has a significantly negative effect on privatization efforts throughout the world, as Brazil and Mexico correctly note. If the US approach were to be applied by all WTO Members, it would without doubt deter those governments which are considering privatizing state-owned companies from doing so, by unfairly punishing the company and its exported products with "countervailing" duties in the complete absence of any countervailable benefit to offset. Such a policy would be contrary to an efficient world economy and would be an incentive to keep subsidized state-owned enterprises in place, or at least significantly impede privatizations by raising the price to be paid for such companies by an artificial US penalty assessment, thus effectively requiring purchasers to pay an amount above and beyond what the market justifies. As Professor Cooper notes in his analysis of the current US practice:

"U.S. countervailing duty practice ensures that countervailing duties will be assessed as *financial penalties* on privatized firms that enjoy no economic benefit from government contributions provided to state-owned predecessors. In these situations, the US is not countervailing any economic benefit conferred on goods crossing our borders. The practice must be seen as *purely protectionist on behalf of US domestic firms in competition with the newly privatized firms.*[98]

18. The EC is of the opinion that the US practice is contrary to the free world trade order. It should not be followed by other WTO Members and should be abandoned by USDOC immediately. The EC has provided the Panel with a number of legal arguments which demonstrate that the US is not only pursuing an economic policy which is flawed, but also that it violates the Subsidies Agreement. The EC will now set out in summary form the legal arguments which it set forth in its First Written Submission.

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96 Fed. Reg. at 37264. See also footnote 36, US First Written Submission (emphasis added).
97 Ibid. at 37263. See also US First Written Submission, at para. 52.
98 Emphasis added.

5. EC Legal Arguments

19. The US, by imposing countervailing duties on leaded bar imports from the UK in the 1995, 1996 and 1997 administrative reviews, has violated the Subsidies Agreement in two respects :

1. the US violates Article 10 Subsidies Agreement in conjunction with Articles 19, 1 and 14 Subsidies Agreement by imposing countervailing duties on the imports of privately-owned companies without first examining or establishing whether there exists any subsidy relating to those imports.

2. the US also violates Article 19:4 Subsidies Agreement by imposing duties in excess of the amount of any subsidy found to exist.

Let me set out these two claims in more detail.

20. First, Article 10 Subsidies Agreement requires WTO Members to ensure that CVD's are imposed only in conformity with the terms of Article VI GATT 1994 and the Subsidies Agreement. Footnote 36 to this key provision sets out clearly that CVD's may only be imposed for the purpose of "*offsetting"* a subsidy. Furthermore, Article 19:1 Subsidies Agreement requires that a Member determine the "existence" of a subsidy, as defined by Article 1 Subsidies Agreement. The extent of the "benefit" considered to be conferred, if any, may not exceed certain market benchmarks set out in Article 14 Subsidies Agreement. If there is no advantage by comparison to that market benchmark, no "benefit" can exist. As explained earlier, if a government-owned company is purchased at arm's-length for a fair market value, then the price necessarily includes the residual value of earlier subsidies. Therefore, the company enjoys no advantage or "benefit" from any prior government funding. The burden of proof, therefore, lies with the investigating authorities to show that a benefit accrues to the new owner of the productive assets following privatization. Imposing CVD's without such an examination violates the Subsidies Agreement.

21. Second, Article 19:4 Subsidies Agreement provides that CVD's may not be "in excess"[99] of the amount needed to offset any subsidy found to exist. Therefore, if the US imposes CVD's on the products of an exporter which has not received a "benefit", the amount of the CVD must necessarily be zero. Therefore, the continuation of *any* CVD level after privatization at arm's length is by definition a violation of Article 19:4 Subsidies Agreement. This provision should be read in context with Article 21 Subsidies Agreement, which sets out rules regarding the *duration and review* of CVD's. If, at the time of a review (which the US is required to do either *on its own initiative* or *upon request* by any interested party) USDOC were to find that a subsidy no longer exists, and it nevertheless continued to require duties to countervail a no-longer-existing benefit, it would be acting in violation of the Subsidies Agreement. It is thus clear that *current* production or merchandise must be benefiting from subsidies in order for CVD's to be imposed on *current* imports.

[99] See also Article VI GATT 1994.

22. These are the main legal considerations on which the EC has based its First Written Submission. The US has failed to counter these arguments. The EC will now deal with six of the more important factual and legal errors made by the US in its first written submission and address each of them in turn.

6. Panel cannot rely on interpretations made by US Courts

23. First, the US relies heavily in its First Written Submission on interpretations given by US courts. The US suggests that these courts have repeatedly affirmed the conformity of USDOC practice with the Subsidies Agreement[100] and that their judgments would therefore be useful for the Panel. Mr. Chairman, this is not the case. The Panel should refrain from drawing any conclusions from judgments by US courts, for the following reasons.

24. The Department of Commerce acts under delegated authority from Congress in administering the US countervailing duty laws. Therefore, *any* analysis by a US court concerning how USDOC treats the issue of privatization and the extinguishment of countervailable subsidies must be addressed in the context of Congress' intent in its enactment of the US Uruguay Round Agreements Act. From a US court's perspective, in exercising its discretion in implementing the change-of-ownership provision in the Uruguay Round Agreements Act, USDOC must do so in faithful observance *of its Congress' intent.* The Subsidies Agreement is irrelevant to the reviewing court.[101] The US Supreme Court has established the standard of review of an agency's (*e.g.* USDOC's) interpretation of a statute entrusted to its administration to be as follows:

> [i]f the intent of Congress is clear ... the court ... *must* give effect to the unambiguously expressed intent of Congress. If, however, … the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a *permissible construction of the statute*.[102]

25. Thus, if the court finds that Congress has not expressed itself unambiguously, the court is asked to determine merely whether the agency's interpretation of *the Congressional statute* is merely reasonable. Thus, the US assertion that its court decisions "represent an independent interpretation" of the US CVD law and the Subsidies Agreement is, at best, disingenuous. Under *Chevron*, the courts do *not* render an independent interpretation.

7. US applies inappropriate standard of review

26. Second, very closely linked to this issue is the US argument that the Panel should somehow apply the standard of review which was set out in Article 17:6

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[100] See US First Written Submission, at para. 61.

[101] The Uruguay Round Agreement is non-self executing under U.S. law and thus had no domestic force absent congressional enactment of the URAA.

[102] *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-43, 104 S.Ct. 2778, 2781-82, 81 L. Ed. 2d 694 (1984) (footnotes omitted) (emphasis added).

of the Anti Dumping (AD) Agreement, which expressly states that permissible interpretations should be deferred to. Mr. Chairman, this suggestion is not new and has already been rejected by the Appellate Body in *Hormones.*[103]

27. Interestingly, in that case the US argued against the use of Article 17:6 outside the framework of the Anti Dumping Agreement. The US is on the record[104] as stating that "the *Decision on Review of Article 17.6 of the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994* shows that Members have yet to decide if the standard of review set out in Article 17.6 of the *Anti-Dumping Agreement* is capable of general application."

28. It is clear that, if the negotiators had wanted to impose a similar standard of review as set out in Article 17:6 AD Agreement on the Subsidies Agreement, they could have done so. The fact that they did *not* do so makes it obvious that they did not want a similar standard to apply to the Subsidies Agreement.

29. Finally, regarding the US argument that the Panel should apply the identical standard of review in a case concerning countervailing duties as in cases concerning anti dumping duties because a Declaration requires "consistent resolution"[105], the EC would make the following points

- The Declaration is not addressed to panels as it is not a covered agreement;
- The Declaration was made in conjunction with the Decision on review of Article 17:6 and is in the nature of a reminder to the Members when they review the application of Article 17:6 to consider the desirability of consistent rules
- Members have not seen fit so far to modify the Agreements in this respect.

8. No "use and effects" test

30. Third, the US on numerous occasions misrepresents the EC's position as requiring an examination into the *use and effects* of subsidies[106], *i.e.* looking what happens with the capital injection once it is made: is the money used to organize a one-off grand party for the company's employees or is it used to purchase the latest technology machinery?

31. Members of the Panel, the US has offered a fundamental mischaracterization of the EC position. The answer to the question whether today's production by a privatized company "benefits" from any subsidies received by a pre-privatized state-owned company does not necessitate an econometric

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[103] Appellate Body Report, *EC Measures Concerning Meat and Meat Products ("EC – Hormones")*, WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998, DSR 1998:I, 135, para. 119. Even though this dispute concerned the application of Article 17:6(i) AD, there is no reason why a different reasoning should apply to the application of Article 17:6(ii) AD.

[104] Ibid., para. 4.2.

[105] See text of Declaration: *"Ministers recognize […] the need for consistent resolution of disputes arising from anti-dumping and countervailing duty measures"*.

[106] See US First Written Submission, for example at paras. 23, 38, 39, 41, 43.

analysis of the effects of subsidies, or an analysis of the uses of the subsidy funds. The EC asks the Member which imposes the CVD to simply explain and justify its basis for concluding that the prior subsidies provide an advantage for the *current* producer and therefore for the production of the exported product. Where it can be determined that a " benefit" no longer exists, a previously set and calculated duty should be abolished immediately. By definition, in the context of an arm's-length fair market transaction, no benefit to the new owner of productive assets exists.

32. It is noteworthy that the US frequently cites USDOC's own pronouncements or the US CVD statute as support for its position. For example in paragraph 41 of the US First Written Submission, the US quotes its US statute as saying that it "does not permit the amount of the subsidy 'benefit' to be re-evaluated based upon the use or effect of the subsidy."

33. Members of the Panel. The EC has never claimed that an Article 1 existence of a benefit analysis constitutes or requires an effects test. Thus, a benefit existence analysis is not "based upon the use or effect of the subsidy." The EC's position is merely that there has to be a basis for concluding that the *current* production of the merchandise subject to countervailing measures is still benefiting.

9. No room for "irrebuttable presumptions"

34. Fourth, a relevant question is the following: Under the Subsidies Agreement, may CVD duties be imposed on the imports of particular merchandise absent a reasonable determination that the manufacture, production, or export of *that* merchandise is benefiting from subsidies? Phrased another way, may a Member *irrebuttably presume* that a benefit continues over time regardless of any event, other than the repayment to the government of the exact nominal amount of the subsidy?

35. Members of the Panel, the EC does not dispute that the Subsidies Agreement allows for a calculation method providing that a subsidy confers a benefit which can be allocated over a period of time. However, the EC does not consider that this presumption is - as the US calls it - irrebuttable. Indeed, there are a number of events which necessarily rebut this presumption, including when a subsidy is either fully or partially repaid, when a subsidy is fully or partially withdrawn, or when there is a change in ownership such as a privatization at fair market value.

This is where the EC and the US differ. The EC considers that allocation of a subsidy over time, using either declining balance or straight line depreciation, is a reasonable and administratively practical method of capturing the benefit of non-recurring subsidies to the extent that they benefit future production. However, the fact that such a method may be reasonable does not relieve the investigating authority from its obligation to examine fundamental changes of circumstances so as to ensure that the subsidy still confers a benefit.

36. In all these circumstances, the CVD should either be withdrawn or reviewed, in accordance with Articles 19 and 21 Subsidies Agreement. The former confirms that "*a countervailing duty shall remain in force only as long and to the extent necessary to counteract subsidization which is causing injury*". Interest-

ingly, even though USDOC claims that it is prevented by the US statute from re-assessing the benefit determination, since it claims to be obliged to "irrebuttably" presume the continuation of the once-obtained benefit by different owners of productive assets, USDOC understands that, in reality, a change of ownership affects its presumption: indeed, USDOC came up with a change of ownership methodology, so as to deal with a modified situation. USDOC recognizes that there is something qualitatively different about privatization.

37. It is here where USDOC introduces its contested calculation of the benefit which has "passed through" . As stated, when a privatization occurs, the US authorities *are* prepared to look into the details of the case. However, they systematically ignore the most relevant evidence, refusing to consider whether or not the change of ownership has taken place at arm's-length for fair market value. In that sense, the US re-instates its automatic and impermissible "presumption" that subsidies provided to a state-owned enterprise provide economic benefit to the new owner, and this *without regard to the conditions surrounding the price paid*.

38. According to the EC, this lack of concern with the *conditions surrounding the actual price paid* is a major omission on the part of investigating authorities. As Professor Cooper says: "[this presumption] has no economic basis in the context of an arm's-length privatization at fair market value", and "[this] presumption states an economic conclusion without having established the residual economic benefit". On the US calculation of benefit during privatization, he notes that it "does not comport with sound economic analysis, market valuation principles or standard business practice." According to this Harvard Professor of International Economics, "the key issue in any privatization transaction is whether fair market value was paid for the productive unit purchased; if so, the residual value of any previous subsidy will have been repaid in the purchase price".

The EC fully agrees. The result of the US methodology and its gamma-based calculation leads to absurd and completely arbitrary results in practice. For example, in order to "extinguish" the subsidy in the case of *British Steel*, the purchasing price would have to have been many times its market value.

39. Finally, another argument which the US has put forward in this regard[107] is the fact that Article 1 is drafted in the present tense. The EC disagrees that the use of the present tense in this provision can somehow lead to the conclusion that an original "benefit" determination irrebuttably remains intact.

40. There is no textual support for this far-reaching conclusion. Indeed, the use of the present tense throughout the text of Article 1, including in its chapeau, must lead to the opposite conclusion. If the drafters had wanted to follow the US approach, whereby the subsidy and benefit would both be granted once-and-for-all, surely they would have used contrasting tenses between the chapeau and the rest. The use of the neutral present tense throughout the text as it stands now to-

[107] US First Written Submission, at para. 118.

gether with the words "thereby conferred" simply requires that there is a clear causal link between the two.[108]

10. Recipient can only be a "legal person"

41. The fifth error by the US concerns the following question: under the Subsidies Agreement, may countervailing duties be imposed on the importation of merchandise that is manufactured, produced, or exported by a business enterprise that was not the beneficiary of the subsidy, in the absence of a reasonable determination that the current producer, and hence its merchandise, is actually "benefiting" in the same way from the subsidies that were in fact received by the former producer?

42. The US position regarding privatization is that subsidies reside in the productive units of a subsidy recipient (and "travel with the productive unit to its new home"). If subsidies are received by (i.e., "reside in) the productive unit, then any producer that subsequently owns that productive unit owns a "subsidized productive unit." In support of its position, the US cites the language of GATT 1994 Art. VI:3 and Art. 10 of the Subsidies Agreement: subsidies are "bestowed … upon the manufacture, production or export of merchandise".[109] That language however does not mean that the 'merchandise' is the beneficiary/recipient of the subsidy, as the US claims.

43. The EC has a fundamentally different view on this issue, which has important repercussions: the EC believes that the only possible "recipient of a subsidy" can be a legal person, never the assets *as such*. A "productive asset" does not have a bank account into which a government financial contribution may flow. It is the legal person which holds the assets and it is the legal person which receives the subsidy.

44. The US position in this respect is contradictory to a principle supported by the US, *i.e.* that 'money is fungible'. It does not matter whether the subsidy arrives in the form of a capital injection transferred directly to the owner or in the form of new machinery delivered at the door of the factory. In both cases, a "financial contribution" is provided to (and benefits) the *firm* . "Production" (when used as a noun) or "merchandise" do not receive contributions or benefits. A company's production of merchandise may benefit from a subsidy, but there is always an entity that produces "production" or "merchandise". Assets do not, in and of themselves, get money or make things.

45. Indeed, if subsidies were granted to assets, the logical consequence of the US position would be that a producer subject to countervailing duties should no longer receive a benefit if he replaced all his assets. However, the US would never lift countervailing duties in such a situation.

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[108] See also Brazil's Third Party Submission, at paras. 28 - 29 and following.
[109] US First Written Submission, at para. 181.

46. The EC position is confirmed by Article 19:3 Subsidies Agreement, which deals with newcomer reviews and focuses on the investigation of the "exporter". According to this provision,

> "[a]ny *exporter* whose exports are subject to a definitive countervailing duty but who was not actually *investigated* […] shall be entitled to an expedited review in order that the investigating authorities promptly establish an individual countervailing duty rate for that *exporter*."[110]

47. Thus, the authorities investigate whether or not the *exporter* received a subsidy. If so, for *this legal person* a countervailing duty rate is set.

48. The fact that recipients of subsidies must be persons rather than goods is also confirmed by the text of Article 2:1 Subsidies Agreement, which lays down the fundamental requirement of specificity of the subsidy to certain *enterprises*.

49. The consequence of this difference of view between the EC and the US is vital, since the EC has asked the Panel to confirm that the WTO Member which applies a CVD identify that a *particular* subsidy has been given to a *particular* beneficiary. The new owner of productive assets has obtained no benefit and a continued countervailing is therefore wholly inappropriate.

11. The object and purpose of the Subsidies Agreement is not to "deter"

50. Sixth, the US in a true crusading spirit, claims[111] that the relevant *object and purpose* of the Subsidies Agreement is "to deter and offset trade-distorting government subsidies benefiting merchandise and causing injury to an industry in an importing country". The EC strongly objects to the introduction of such a misleading statement, for the following reason.

51. There is no justification for announcing that the Subsidies Agreement or CVD's are meant to "deter" governments from granting subsidies. "Deterrence" contains the notion of threat and punishment.[112] There is no basis in the Subsidies Agreement or the decided cases for such an aggressive approach. The US interpretation of the Subsidies Agreement as a "deterrence" to governments is totally misplaced. On the contrary, the whole design and structure of the Subsidies Agreement indicates that with the exception of the narrow prohibited subsidies category (export and local content subsidies) governments can legitimately grant subsidies so long as these cause no adverse effects; the spirit of the Subsidies Agreement therefore is towards disciplining subsidies in the exceptional case they cause such adverse effects and not to deter governments from granting subsidies in the first place. The object and purpose of the countervailing duty provi-

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[110] Emphasis added.

[111] US First Written Submission, at para. 150.

[112] The 1993 *New Shorter Oxford English Dictionary* explains "to deter" as to "restrain or discourage (from acting or proceeding) by fear, doubt, dislike of effort or trouble, or consideration of consequences".

sions is to allow Members to protect their industry from the injurious effects of subsidies of other Members.

In the view of the EC the US approach, if accepted, could risk governments imposing CVD's without legal constraint or boundary. The US eagerness to use CVD's to deter and punish is particularly clear from the "rich uncle" hypothetical. The claim that a subsidy (always?) results in lowered market prices, higher output, reduced value for companies, and ultimately survival of firms that would otherwise have failed is false.[113]

52. In any event, the *British Steel* case concerns a totally different situation. Most of the subsidy funds covered operating losses and payments to retiring workers. The funds did not "create" plants or assets that wouldn't have otherwise existed or that added future value to the enterprise. Rather, the company's capacity was significantly reduced during the period prior to privatization. The US is aware of each of these facts.

53. There is another fundamental problem with the US approach itself. Although the allocation over time methodology represents an acceptable presumption, this does not mean that it reflects the real past and future benefit of the subsidies. In real life, the real amount of subsidy which remains outstanding and is repaid when a company is privatized may be very different to the amount outstanding under the US allocation methodology - indeed, the US privatization methodology contradicts its own allocation methodology. This does not mean that the US methodology is unreasonable, but it is not for the US to second guess the market.

54. In addition, if the merchandise against which the CVD is imposed is not benefiting from subsidies, there is no "offsetting" and, hence, the duty is not a *countervailing* duty. The US is in effect redefining what it means to "countervail".

55. Finally, the US implicitly argues that CVD's should be imposed in certain circumstances to avoid "circumvention". There is absolutely no evidence of "circumvention" in the present *British Steel* case and it is irrelevant, by definition, in arm's-length market value transactions.

12. Other legal arguments

56. The earlier-mentioned issues contain the six more important legal and factual errors made by the US in its First Written Submission. As stated earlier, the EC will deal with each of these errors in more detail in its Second Written Submission. Now, the EC would like to deal with two remaining legal points which deserve attention.

[113] See US First Written Submission, at paras. 214, 218, 222, and note 137.

13. Article 27:13 Subsidies Agreement

57. First, in order to find support for the argument that subsidies paid before privatization remain in all cases allocable after privatization, the US relies heavily on Article 27:13 Subsidies Agreement. The US draws quite sweeping a-contrario-based conclusions, which, Mr. Chairman, should not be allowed so stand, for a number of reasons.

58. To begin with, Article 27:13 does not at all address the issue which is key to the present dispute, i.e. whether a benefit will "pass through" to the new owner of a previously government-owned and subsidized company, when it is sold at arm's-length for fair market value. In spite of the US' assertions, Article 27:13 also says nothing about the argument that a "benefit" should be *identified* and *measured* only *once*.

59. Instead, Article 27:13 gives developing country governments a break by excluding certain subsidies from Part III of the Subsidies Agreement. The US reads in this provision much more than was ever intended. It, and I quote, sees not only a "strong implication", but also it builds on "unstated premises" and "implicit assumptions", and concludes that these unilateral assumptions could somehow trump the plain text of the Subsidies Agreement. Rather, the only implication of the affirmative language in Article 27.13 is that there is no safe harbour from CVDs for non-developing countries with regard to new subsidies provided in the context of a privatization. Its says absolutely *nothing* about prior subsidies or their pass-through. The US interpretation is a significant mischaracterization.

60. Moreover, Article 27:13 is far from applicable in the present dispute: the UK is not a developing country and the subsidies given by the UK government at the time were not given, as is required by Article 27:13, in the context of a privatization. Also, as Brazil correctly states in its Third Party Submission[114], this provision addresses an exception to Part III, and "[t]hus, it can only be presumed that the negotiators purposefully excluded any reference to Part V of the Subsidies Agreement".

14. EU State Aids rules

61. A second argument of the US which deserves brief comment here is its contention that the EC takes a different view of the relevance of a change of ownership in its internal State aid rules to that which the EC argues should be followed with respect to countervailing duties.[115]

Mr Chairman, Members of the Panel, this is a red herring. Let me briefly explain why.

- The *substantive rules* applying to EC State aids are entirely different from those applying to countervailing duty proceedings. Article 87 of the EC Treaty (formerly Article 92) prohibits, subject to

[114] Brazil's Third Party Submission, at para. 83.
[115] US First Written Submission, at paras. 227 to 233.

certain exceptions, State aid "which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods … insofar as it affects trade between Member States."

- Further, the *applicable procedure* involves prior notification and approval or disapproval by the EC Commission *before the aid may be granted*.[116]
- The *remedy* against the granting of state aids not allowed by the EC Treaty is never the imposition of corrective duties but a *retro-active* declaration of illegality which may entail the reimbursement of the aid. Countervailing duties can only be imposed on merchandise which *currently* benefits from a subsidy.
- More fundamentally perhaps, the *object and purpose* of the EC State aid rules is to avoid and if necessary to remedy *distortions of competition within the EC* arising from the grant of State aid, at least to the extent that the distortions are contrary to the common interest. The purpose of countervailing duty measures duties is quite different, as we have explained above, and is to protect the internal market of another WTO Member by means of an offsetting duty at its border. They do not seek to remove any distortion of competition in the country where the producer is located, only to shelter the importing country from the effect of the subsidy.

62. For all these reasons, the EC's policy concerning its own internal State aids has no bearing on the correct interpretation of the countervailing duty rules in the Subsidies Agreement. Indeed the US admits that the EC has never applied a "pass-through " methodology in its own countervailing duty practice.[117] The US merely argues that the EC has stated that State aid rules may be *relevant* for the EC's countervailing duty regulation.[118] This is rather misleading. The statement in the EC Commission calculation guidelines to which the US refers was not at all of general applicability but related to a narrow and special case which had nothing to do with privatisation or the pass-through of subsidies. Thus applying the principle of treaty interpretation on which the US itself relies[119] - *expressio unius es exclusio alterius* - one can even come to the conclusion that EC State aid rules are not at all relevant in other respects!

63. In any event, what the Commission actually said [120] is that, as regards equity infusions, it would make an assessment "on a case-by-case basis, taking account of the Commission's practice as regards state-aid policy in this area and the practice of the Community's main trading partners." That hardly indicates that

[116] See Article 88 EC Treaty (formerly Article 93).
[117] US First Written Submission, at para. 227.
[118] Ibid., at para. 232.
[119] Ibid., at para. 154.
[120] Guidelines for the Calculation of the Amount of Subsidy in Countervailing Duty Investigations, OJ C 394, 17.12.98, at page 10, 11.

State aid rules will be followed in countervailing duty cases, even in the special case to which this comment relates.

15. Conclusion

64. In conclusion, the EC respectfully requests that the Panel find that by imposing countervailing duties on leaded bar imports from the EC in the 1995, 1996 and 1997 administrative reviews, the US has violated Article 10 Subsidies Agreement, read in conjunction with Articles 19, 1 and 14 and Article VI GATT 1994, by imposing countervailing duties where no subsidy exists. Equally, the Panel is requested to find that the US violated Article 19:4 Subsidies Agreement by levying countervailing duties on imported products in excess of the amount of any subsidy found to exist. The EC requests that the Panel recommend that the US immediately bring its measures into conformity with its obligations.

65. However, Mr. Chairman, members of the Panel, such an outcome will not necessarily change the US practice in future. Indeed, the US may well conclude that, as a result of such a limited Panel recommendation, it would be allowed to maintain its countervailing duty laws as presently drafted. This would, in the EC's view, be largely insufficient. The EC therefore requests the Panel, in line with Article 19:1 DSU, to suggest that the US amend its countervailing duty laws to recognize the principle that a privatization at market price extinguishes subsidies.

66. Thank you for your attention.

16. EC Concluding Statement

Mr. Chairman, distinguished Members of the Panel. The EC would like to make some concluding statements. However, before doing so the EC wishes to thank you for the professional way in which you have handled the proceedings over the last two days, which has allowed the parties to engage in an interesting debate. We are looking forward to receiving your further questions in writing. The EC would like to make the following brief points.

First, the EC understands that the US is asking the Panel to accept the proposition that it has the right to impose countervailing duties on newly privatized companies without investigating whether or not these companies have actually benefited from a subsidy. The US authorities claim that it is sufficient for them to carry out only *one* examination regarding a subsidy to the former state-owned company, many years in the past, while subsequently *disregarding* completely a fundamental change in circumstances such as an arm's-length privatization at fair market value. As well as defying all economic logic (confirmed by Professor Richard N. Cooper), this approach is inconsistent with the Subsidies Agreement, which contains the principle that a subsidy only exists if a benefit is conferred on the company which is subject to countervailing measures.

Second, the EC would like to touch upon the question of the appropriate *standard of review* for this case. The US has proposed that the Panel should consider interpretations of US national courts on the subject of pre-privatization subsidies. The EC has already strongly rejected this idea in its opening statement, for the following reason: the *Chevron* doctrine, where any permissible interpretation

must be respected by the national courts, is not applied within the framework of the WTO, except in the case of Article 17:6 Anti Dumping Agreement. The US has requested that the Panel rely on this provision in the framework of the Subsidies Agreement. Mr. Chairman, as discussed earlier, this cannot be allowed.

The EC will set out its arguments regarding the appropriate standard of review for the present dispute in its Second Written Submission in more detail, but would already today underline that, compared to the situation before 1995, the WTO Agreement has significantly changed the applicable standard of review. For example, before 1995 Articles 3:2 DSU and 11 DSU did not exist, and thus Panels were not following the rules of interpretation used in International Law. Therefore, the US should not be able to rely on the two pre-WTO cases which it has mentioned in paragraphs 58 of its Oral Statement, i.e. the *United States Salmon* case and the *New Zealand Electrical Transformers* case. In addition, the *United States Salmon* case was dealt with by a panel under the Tokyo Round Subsidies Code whose terms of reference were restricted to that Agreement. It is therefore not even a GATT 1947 case.

Third, the US has laid great stress on the *object and purpose* of the Subsidies Agreement. It has made it clear in its response to our questions that it considers the elimination of a benefit not a sufficient reason for removing a countervailing duty, since it considers that the object and purpose of Part V ASCM is to "deter" distortions of trade, even if no financial benefit remains with the company after privatization. The EC contends that correction of any supposed market distortion (for which in any case no evidence has been produced by the US in the present dispute) is not provided for in the Subsidies Agreement. The WTO Agreement is designed to promote world trade, not to remove market distortions. Countervailing duties, unless justified, *restrict* world trade, a point well made by Mexico earlier. If British Steel plc. were required to pay countervailing duties, this would in fact *create* a new market distortion.

Fourth, the US position that "subsidies travel with the assets" is in contradiction with the US principle that "money is fungible. Subsidies which are "glued to the assets" are by definition *not* fungible. The result of applying the principle that "subsidies travel with the assets" is that it would be sufficient for a company to sell its existing assets in order to escape a previously imposed duty. Therefore, the Panel should follow the EC position that a subsidy of the kind we are discussing here is granted to the *owner of the assets*, not to the assets *as such*.

Fifth, the EC does not ask the Panel to confirm that *any* change in circumstances requires a new investigation whereby the conditions for countervailing duties should be determined. During the last two days many hypotheticals have been discussed which may constitute some change in circumstances, but certainly not all of these would constitute a *fundamental* change in circumstances. What the EC expects from the US is that if a fundamental change occurs, this would give rise to a proper review of the justification for the duty. A change in ownership from the government to a private owner *is* such a fundamental change and would therefore merit a new examination of the existence of the "benefit" requirement for the new owner.

Thank you.

ATTACHMENT 1.3

RESPONSES OF THE EUROPEAN COMMUNITIES TO WRITTEN QUESTIONS FROM THE PANEL FIRST MEETING OF THE PANEL

(30 June 1999)

The European Communities respectfully provides the following answers to the Panel's questions.

1. QUESTIONS FOR BOTH PARTIES

Q.1. If a new rate of subsidization is being established in the course of a review (either under Article 19 or Article 21 of the SCM), according to data for the relevant period of review (POR), are parties of the view that this involves determining whether subsidization continued over the POR? Or could a new rate be determined without establishing whether subsidization continued?

Response of the European Communities:

It is necessary to establish that subsidization continues before establishing a new rate. Article 21.2 ASCM is very clear on this. It requires an examination of "*whether the continued imposition of the duty is necessary to offset subsidization*"[121] [1] and, therefore, of whether subsidization continues. The sentence would not make sense if it were possible for Members to continue to impose *offsetting* countervailing duties without the need to examine whether subsidization continues. In addition, the continuous aspect of subsidization is reflected in the use of the wording in Article 21.1 ASCM, which speaks of "*subsidization which is* causing *injury*".

Article 19.1 is even clearer, requiring a determination of the "*existence*" of a subsidy. By definition, if there is no "benefit", no subsidy can "exist" for the purposes of Article 19. Article 19.3 also supports this conclusion. It refers to the imposition of countervailing duties on parties other than those which "*have renounced any subsidies*", thus indicating that renouncement of a subsidy eliminates subsidization and, consequently, the need to impose duties. Finally, Article 19.4 also lends significant support to this conclusion, referring to " *subsidies found to exist*", *not* to "*subsidies found to have existed*".

Q.2. Are parties of the view that establishing whether subsidization continued over the POR involves looking at whether a financial contribution conferring a benefit took place over the POR? Or could one establish the existence of subsidization during the POR without assessing whether a financial contribution conferring a benefit was made during the same period?

[121] See also Article 10, footnote 36 ASCM.

Response of the European Communities:

A subsidy must be found to *exist* during the POR before the goods of a company may be legally countervailed under Part V ASCM. While it is not necessary that a financial contribution occur during the POR, any benefit conferred thereby must be conferred in the POR in order for a countervailing duty to "offset" a subsidy. According to Article 14 ASCM, the amount of the subsidy must, for the purposes of Part V on countervailing duties, be limited to the amount of the benefit to the recipient and therefore this is the element that must be present and measured during the POR.

II. QUESTIONS FOR THE EUROPEAN COMMUNITIES

1. At para. 237 of its first written submission, the United States suggests that the administrative reviews at issue were conducted under Article 21.2 of the SCM Agreement. This was confirmed by the United States at the first substantive meeting. Does the EC agree that the administrative reviews at issue were Article 21.2 reviews?

Response of the European Communities:

Yes. The European Communities agree that the administrative review appears to have been conducted on the basis of Article 21.2 ASCM, but has requested confirmation by the US in the EC's questions.

A review can only confirm or modify (include terminating) an original finding which led to the imposition of a countervailing duty under Article 19.1 ASCM (" … *a Member …may impose a countervailing duty* …"). Article 21.2 ASCM contains guidance on reviews. Article 21.2 requires reviews to be conducted (either on Members' own initiative or upon request by any interested party), but the conditions to be fulfilled before duties can be imposed or maintained remain those of Article 19.[122]

The European Communities have not alleged a breach of Article 21 ASCM since the US did, in fact, conduct reviews. We are alleging a breach of Articles 1, 10 and 19 since the conditions and requirements set out in those provisions were not respected in conducting those reviews (please note that the European Communities have referred in paragraph 124 of its First Written Submission to Article 21.2.)[123]

[122] For example, Article 19.4 does not allow a countervailing duty to exceed the amount of subsidy found to exist. If Article 19 did not apply to review proceedings Members could impose duties - following reviews - which far exceeded the amount of subsidy.

[123] This para. reads as follows: "Thus, in conformity with the context, object, and purpose of the countervailing duty rules, as set forth in Section A above, Article 19.4 and Article VI of GATT 1994, read in conjunction with Article 21.1, 21.2 and 19.1, establish that Members must ensure that trade is not impeded by imposition of countervailing duties at a level more than necessary to offset the benefit enjoyed by such imported merchandise".

2. Does the EC consider that an arm's length privatization at fair market value gives rise to a presumption that non-recurring subsidies bestowed on a government-owned company are extinguished through privatization?

Response of the European Communities:

Following a fundamental change in circumstances, such as a privatization, investigating authorities have the burden to determine that the privatized company has obtained a benefit from the pre-privatization financial contributions granted to the prior state-owned company. This determination must be made on the basis of *positive* evidence, *not* on the basis of an "irrebuttable presumption" that benefits established to unrelated prior state-owned companies automatically accrue to the successor company simply because a privatization occurred within a benefit stream period previously established for a prior state-owned company. An arm's-length privatization for fair market value, by definition, precludes the notion that any "benefit" can "pass through" to the new private owner as a basic matter of economics. The EC would not term this a presumption so much as a basic matter of economic reality. What is clear is that there is no benefit to the new company - it has no advantage by reference to the market and the marketplace benchmarks set forth in Article 14.

3. Please comment on USDOC's findings regarding extinguishment of subsidies potentially allocable to Richemont (Exhibit USA-30) in light of footnote 17 to the EC's first written submission.

Response of the European Communities:

The EC would very much appreciate the opportunity to comment on USDOC's findings with regard to the Richemont spin-off in light of footnote 17 of its first written submission. However, the Federal Register Notice provided by USDOC only draws a brief conclusion. It does not contain any of the details of the sale or the essential figures used by USDOC to draw its mathematical conclusion. As USDOC's privatization and "spin-off" methodologies are based on an arbitrary formula rather than an assessment of the existence of a benefit, the European Communities respectfully request that the Panel ask the United States to provide all parties with those facts, including: (1) the essential USDOC spin-off calculation worksheets containing all the specific numbers that led to the conclusions drawn by USDOC regarding the spin-offs in the case, and (2) all supporting memorandums, including the portion of the verification report dealing with Richemont cited by the USDOC at 64 Fed. Reg. 30776. The European Communities then request the opportunity to respond to that information.

In the interim, the EC would make the following comments on the limited information presented in the Federal Register Notice. First, in its oral statement the US implies that USDOC "pays particular attention to the facts of each case" and, as a result, apportioned none of the subsidies to the company under investi-

gation in *Stainless Steel Sheet and Strip in Coils from France ("SSSS in Coils").*[124] This is inaccurate. As the Federal Register Notice makes clear, Richemont was not the company under investigation in the *SSSS in Coils* case. Rather, it was spun off *prior* to the investigation of Usinor in *SSSS in Coils*. Under the USDOC *spin-off* methodology, subsidies are *never* "extinguished." Rather, "the full amount of the prior subsidies is allocated between the seller and purchaser and remains countervailable."[125] In this instance, USDOC apparently apportioned all of the pre-privatization subsidies to the company it was investigating - Usinor. Most importantly, in its examination of the "facts" USDOC took no account of whether any "benefit" as defined by Article 1 and 14 ASCM was ever conveyed on that purchaser. To USDOC, this fact is "irrelevant" in its spin-off or privatization practice.[126] Rather, it applied a self-derived formula on which the EC can provide additional specific comments when provided with the information used by USDOC.

Second, from the information provided in Exhibit USA-30, the European Communities call to the Panel's attention an important inconsistency in the methodologies applied by USDOC in the case provided.[127] In considering whether Usinor received a countervailable subsidy from its 1994 sale of CSR to a government entity, USDOC comments that it examined whether Usinor "*received more than a reasonable market price from the EDF in this transaction*," including such factors as the *"independent valuations of the transaction based on detailed projections of future costs and revenues"*. USDOC "*found no evidence to indicate that the transaction was anything other than an arm's length transaction for full market value. Accordingly, we determine that this programme does not constitute a countervailable subsidy…*".[128] The USDOC concluded that the seller did not obtain a benefit *because* the transaction was at arm's length for full market value. This analysis is consistent with Articles 1 and 14 of the ASCM, but it is remarkably never applied by USDOC in the context of an arm's-length market value privatization. Rather, USDOC instead applies its "irrebuttable presumption" theory. There is no justification for the differential treatment illustrated in detail in this rather revealing decision.

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[124] See US Oral Statement at para. 46.
[125] See US First Written Submission at para. 54.
[126] See GIA at page 37264.
[127] See pages 30781-82 of the Federal Register Notice supplied in Exhibit USA-30 ("A. Purchase of Power Plant").
[128] See page 30782 of the Federal Register Notice supplied in Exhibit USA-30 ("A. Purchase of Power Plant").

ATTACHMENT 1.4

RESPONSE OF THE EUROPEAN COMMUNITIES TO WRITTEN QUESTIONS FROM THE UNITED STATES

(30 June 1999)

The European Communities responds as follows to the written questions from the United States:

SCM Agreement Requirements

Q.1. Does the EC agree that the SCM Agreement requires the investigating authority to establish a "benefit" within the meaning of Article 1.1 as of the time of the subsidy bestowal with regard to each subsidy that it countervails? For example, if a financial contribution is made in 1985, and the period of investigation or the period of review is 1990, does the EC agree that the SCM Agreement requires the investigating authority to establish the benefit from the financial contribution based on the circumstances prevailing as of 1985?

Response of the European Communities:

By using the term "subsidy bestowal" the US appears to assume that a "financial contribution" and a "benefit" are *always* simultaneous and instantaneous. This is not true. Nothing in the ASCM requires a benefit to be conferred at the same time as a financial contribution. The investigating authorities must establish the existence of a benefit to the producer under investigation *during* the period of investigation (POI) or the period of review (POR). It is this producer on whose goods a WTO Member may impose *offsetting* countervailing duties, if a subsidy is found to exist.

If, as in the US example, a non-recurring financial contribution was made in 1985, and the POR is 1990, the investigating authority could assume that the financial contribution confers a continuing benefit on the company under investigation in 1990, based on the circumstances prevailing as of 1985. However, it should be noted that the investigating authorities *assume* that the subsidy is not repaid, that the producer investigated in 1985 is the same in 1990, and that no fundamental change in circumstances occurs such as a privatization. If any of these events occur, the assumption necessarily is no longer valid and the conditions, including the existence of a 'benefit' have to be determined under the changed circumstances.

In the present dispute, no financial contribution has been made to BS plc and no benefit has been conferred on BS plc. The US has investigated and reviewed *BS plc*, a private company. The US irrebuttably, automatically and incorrectly presumed that a benefit had been conferred on BS plc.

Q.2. If the EC contends that it is ever not necessary for the investigating authority to establish a "benefit" within the meaning of Article 1.1 as of the time of the subsidy bestowal with regard to each subsidy that it countervails, please explain under what circumstances it is not necessary for the investigating authority to do so. In addition, please cite to the particular provision of the EC's countervailing duty law, or the EC's practice thereunder, if any, showing how the EC has addressed the matter.

Response of the European Communities:

Not applicable. See answer to question 1.

Q.3. Does the EC contend that the SCM Agreement requires the investigating authority to establish a "benefit" within the meaning of Article 1.1 as of a time subsequent to the time of the subsidy bestowal under any circumstances other than a privatization or other change in ownership of a subsidized company?

Response of the European Communities:

The investigating authorities *must*, *in all cases*, establish the existence of a benefit to the producer under investigation *during* the period of investigation (POI) or the period of review (POR), independently of whether or not the financial contribution was made before or during the POI or POR. For a subsidy to *exist*, there *must* be a benefit. In the present dispute, the US has countervailed the goods of a company for which it never first established the existence of a benefit.

Q.4. If the EC's answer to the previous question is yes, please answer the following questions.

a. Explain under what circumstances it is necessary for the investigating authority to establish a "benefit" within the meaning of Article 1.1 as of a time subsequent to the time of the subsidy bestowal;

Response of the European Communities:

See answer to question 3.

b. Explain how the investigating authority would make the determination regarding whether that "benefit" existed;

Response of the European Communities:

Investigating authorities must ascertain that non-recurring financial contributions provide a benefit to the producer under investigation. Article 14 ASCM prescribes the methods by which an investigating authority shall calculate the "benefit to the recipient conferred", if any, as a result of a government financial contribution. Article 14

provides that a variety of financial contributions by a government "shall not be considered as conferring a benefit" unless they are inconsistent with commercially meaningful benchmarks.

c. Cite to the particular provision of the EC's countervailing duty law, or the EC's practice thereunder, if any, showing how the EC has addressed the matter.

Response of the European Communities:

Article 15.1 of Regulation 2026/97 prevents a countervailing duty being imposed if "it has been demonstrated that the subsidies no longer confer a benefit on the exporters involved".

Q.5. Does the EC contend that the SCM Agreement requires the investigating authority to establish that a "benefit" within the meaning of Article 1.1 continues to exist as of the time of the period of investigation or the period of review? For example, if a financial contribution is made in 1985, and the period of investigation or the period of review is 1990, does the EC contend that the SCM Agreement requires the investigating authority to establish the benefit from the financial contribution based on the circumstances prevailing as of 1990?

Response of the European Communities:

Yes. See, in particular, the European Communities' response to Question 1, above.

Q.6. If the EC's answer to the previous question is yes, please answer the following questions.

a. Explain how the investigating authority would make the determination regarding whether that "benefit" existed.

Response of the European Communities:

This depends on the facts of each case but some situations have been described in the answer to question 4(b) above.

b. Cite to the particular provision of the EC's countervailing duty law, or the EC 's practice thereunder, if any, that reflects this requirement.

Response of the European Communities:

Please see the answer to Question 4(c).

Q.7. The EC seems to contend that the SCM Agreement *requires* the investigating authority to establish a "benefit" within the meaning of Article 1.1 as of the time of the privatization or other change in ownership of a subsi-

dized company. Can the EC cite the specific language in the SCM Agreement that establishes this supposedly mandatory rule? Here, the United States is not seeking a reference to the Article on which the EC relies or an entire quotation of the entirety of the Article, but rather the specific language in the Article on which the EC relies.

Response of the European Communities:

The EC's position is that, in order for a countervailing duty to be imposed (or to continued to be imposed), it must be demonstrated that a producer was granted countervailable subsidies during the POI or POR. A benefit is required by Article 1.1 ASCM. "A benefit is thereby conferred" refers to the company subject to investigation, during the period of investigation. A basic duty under Part V ASCM is to calculate countervailing duties that *offset* the subsidy found to exist. Article 19.3 ASCM provides for individual countervailing duty rates for exporters. As the EC said in its concluding remarks at the end of the First Substantive Meeting with the Panel: "the EC does not ask the Panel to confirm that *any* change in circumstances requires a new investigation whereby the conditions for countervailing duties should be determined. …. What the EC expects from the US is that if a fundamental change occurs, this would give rise to a proper review of the justification for the duty. A change in ownership from the government to a private owner *is* such a fundamental change and would therefore merit a new examination of the existence of the "benefit" requirement for the new owner".

Q.8. Assuming for the sake of argument that the SCM Agreement requires an investigating authority to identify a "benefit" within the meaning of Article 1.1 accruing to the owners of the successor, privatized company as of the time of a privatization transaction, as the EC argues, can the EC cite the specific language in the SCM Agreement that establishes the additional mandatory rule that an arm's length, fair market value privatization transaction eliminates all previously bestowed subsidies? Here, again, the United States is not seeking a reference to the Article on which the EC relies or an entire quotation of the entirety of the Article, but rather the specific language in the Article on which the EC relies.

Response of the European Communities:

There is, in particular, a requirement in Article 1.1 ASCM that a subsidy only exists where there is a benefit. In addition, as the US revealingly notes in Exhibit USA-30, a "*programme does not constitute a countervailable subsidy"* where USDOC finds *"no evidence to indicate that the transaction was anything other than an arm's length transaction for full market value*".[129]

[129] See page 30782 of the Federal Register Notice supplied in Exhibit USA-30.

Q.9. Can the EC describe how it determines, under its countervailing duty law or practice, whether a subsidy has been repaid?

Response of the European Communities:

The European Communities have no practical experience with such a situation. The EC's approach would be to consider the subsidy eliminated if the company concerned had repaid to the granting authority an amount corresponding to the remaining benefit. In the case before the Panel, no subsidy to BS plc exists so it does not have a subsidy to "repay".

Q.10. The EC seems to take the position that the SCM Agreement requires the investigating authority to treat an arm's length, fair market value privatization transaction as extinguishing all pre-privatization subsidies. The EC explains that the object and purpose of the SCM Agreement focuses on what commercially meaningful advantage is accruing to the owners of the successor, privatized company. In taking this position, the EC relies on Article VI:3 of GATT 1994 and Articles 10 and 19.4 of the SCM Agreement. Taking the foregoing into account, please answer the following questions:

a. Does Article VI:3 of GATT 1994 make any express reference to the owners of the producer or exporter of the merchandise?

b. Does Article VI:3 of GATT 1994 even make any express reference to the producer or exporter of the merchandise?

c. Although the EC quotes Article VI:3 of GATT 1994 in its entirety in its First Submission, the EC does not identify the precise textual language on which it relies to support its view that the object and purpose of the SCM Agreement focuses on what commercially meaningful advantage is accruing to the owners of the successor, privatized company. Can the EC identify the precise textual language on which it relies in this regard?

d. Does Article 10 of the SCM Agreement make any express reference to the owners of the producer or exporter of the merchandise?

e. Does Article 10 of the SCM Agreement even make any express reference to the producer or exporter of the merchandise?

f. Although the EC quotes Article 10 of the SCM Agreement in its entirety in its First Submission, the EC does not identify the precise textual language on which it rely to support its view that the object and purpose of the SCM Agreement focuses on what commercially meaningful advantage is accruing to the owners of the successor, privatized company. Can the EC identify the precise textual language on which it relies in this regard?

g. Does Article 19.4 of the SCM Agreement make any express reference to the owners of the producer or exporter of the merchandise?

h. Does Article 19.4 of the SCM Agreement even make any express reference to the producer or exporter of the merchandise?

i. Although the EC quotes Article 10 of the SCM Agreement in its entirety in its First Submission, the EC does not identify the precise textual language on which it relies to support its view that the object and purpose of the SCM Agreement focuses on what commercially meaningful advantage is accruing to the owners of the successor, privatized company. Can the EC identify the precise textual language on which it relies in this regard?

Response of the European Communities:

The premise to these questions is not correct. The European Communities have not suggested that "the object and purpose of the ASCM focuses on what commercially meaningful advantage is accruing to the owners of the successor privatized company." The EC's position is that under the ASCM it must be demonstrated that the current producer being investigated, and potentially subject to countervailing duties, benefits during the POI or POR from a financial contribution.

As regards subparts (a), (b) and (c), Article VI :3 of GATT 1994 refers to a subsidy granted "upon the manufacture, production or export" of the product concerned. Only subsidies granted to these activities can be subject to countervailing duties. However, countervailing duties are not imposed on activities. They can only be imposed on products from particular producers that have benefited from financial contributions. The production process is an economic activity carried on by producers. Accordingly, it is those producers that can be subsidized. "Production" or "merchandise" do not receive contributions or benefits. The Article VI :3 language cannot and does not mean that the merchandise is the recipient of the subsidy. The European Communities consider that this must refer to the *current manufacturer, producer or exporter of the product*. Indeed, even US law recognizes that a subsidy exists when a financial contribution is provided "to a person" and a benefit is conferred.[130]

Questions (d), (e) and (f) and (g), (h) and (i) repeat *mutatis mutandis* questions (a), (b) and (c) and so the same answer applies *mutatis mutandis*.

Q.11. In the EC's Oral Statement, the EC now argues that the recipient of the Article 1 "financial contribution" must be a "legal person," meaning essentially a company. The United States notes that the SCM Agreement does not expressly address this matter, but it would seem that as a practical matter when a government provides subsidy funds, there must be some entity that receives, or takes possession of, those funds. In any event, after

[130] See 19 U.S.C. §1677(5)(B).

stating this notion, i.e., the notion that a "legal person" is what receives the subsidy funds, the EC then extends it in two ways. In this regard, the EC first states, essentially, that because a "legal person" is what as a practical matter receives the subsidy funds, Article 1.1's bare reference to "benefit" really must mean "benefit to a legal person" or, in other words, "benefit to a company." Second, without even acknowledging that it is doing it, the EC then takes "benefit to a company" and turns it into "benefit to the owners of a company." Taking the foregoing into account, please answer the following questions:

Response of the European Communities:

Again the premise of the question reflects a misunderstanding and mischaracterization of the EC position. The European Communities consider that there must be a benefit to the producer investigated.

a. With regard to its first extension, or leap of logic, can the EC clarify what specific text in the SCM Agreement supports its conclusion that "benefit" in Article 1.1 really means "benefit to a company"? In the United States' view, even accepting the notion that, as a practical matter, there must be some entity like a company that actually receives the subsidy funds, it is a separate issue as to who or what the Article 1.1 "benefit" is conferred on. The United States would note that, in its First Submission (at paragraphs 189-98), the United States explains in some detail how Article VI:3 of GATT 1994 and Articles 10 and 19.4 of the SCM Agreement focus on the benefit to the merchandise rather than the benefit to the company. How does the EC consider that these provisions support its conclusion that "benefit" in Article 1.1 really means "benefit to a company"?

Response of the European Communities:

The fact that "benefit" refers to a benefit to the producer/exporter is supported in particular by: Article 2 (specific to an enterprise), Annex I (a) (subsidies to a firm), Annex IV.2 (recipient firm), Article 11.2(ii) (the identity of each known exporter or foreign producer), and Article 14 (benefit to the recipient).

The focus on the merchandise of some provisions of Part V of the ASCM is because, as discussed above, the method used to countervail subsidy is by imposing duties on exported merchandise.

b. The EC's second leap of logic is even more tenuous, and the EC provides no explanation of it. Can the EC state its rationale for concluding that a "benefit to a company" really means a "benefit to the owners of a company"? In addition, can the EC cite to the specific text in the SCM Agreement on which this conclusion is based?

Response of the European Communities:

The question is based on a misunderstanding, as explained above.

Q.12. In taking the position that the SCM Agreement requires the investigating authority to treat an arm's length, fair market value privatization transaction as extinguishing all pre-privatization subsidies, it appears that the EC is assuming that 100 per cent of the government-owned company is sold to a privately owned company or other private entity or to an individual. Please answer the following questions which attempt to clarify the position being taken by the EC:

a. Can the EC explain how the SCM Agreement treats a sale of 75 per cent of a government-owned company to a privately owned company or other private entity or to an individual? For example, would all of the prior subsidies still be extinguished or only 75 per cent of them?

b. What if only 50 per cent of the government-owned company were sold?

c. What if only 25 per cent of the government-owned company were sold?

d. Please explain what the SCM Agreement requires in each of the above situations.

Response of the European Communities:

The question is again based on a misstatement of the EC position. The European Communities are asserting that the new producer/exporter must be shown to benefit and that this cannot be "irrebuttably" presumed. Whether the new producer/exporter which has purchased assets has obtained a benefit depends, of course, on the terms of the transaction (fair market value, arm's length transaction). A member is not excused from an existence of benefit analysis and the US itself performs this analysis regularly in just these types of situations. See, for example, response to question 8 and footnote 2, above.

Q.13. In the EC's view, how does the SCM Agreement require an investigating authority to handle the pre-privatization subsidies in the following situation. Here, assume that a government-owned company which previously had received a grant of £100 million in 1985 is privatized in an arm' s length, fair market value transaction in 1988 and then, one year later, in 1989, the government re-nationalizes the company? If the period of investigation or the period of review is 1990, and the investigating authority is examining the re-nationalized company, how does the SCM Agreement require the investigating authority to treat the £100 million grant? Please explain.

Response of the European Communities:

The investigating authorities must *in all cases* establish the existence of a benefit to the producer under investigation *during* the period of investigation (POI). Whether the purchaser has obtained a benefit depends on the circumstances of the transaction. Article 14 ASCM provides several benchmarks. With regard to the privatization of a state-owned company, when a private buyer purchases a company or assets thereof at arm's length for fair market value, this precludes the notion that any "benefit" passes through. With regard to the government purchase of a company, the European Communities respectfully refer the US to its own analysis in the *Stainless Steel Sheet and Strip from France* case submitted as Exhibit USA-30.[131] There, the US claims it examined whether "more than a reasonable market price" was received from the government in the transaction. Because USDOC "found no evidence to indicate that the transaction was anything other than an *arm's-length transaction for full market value*", they held that "this programme *does not* constitute a countervailable subsidy ... ".[132] The European Communities are in accord with this *benefit* analysis as the proper framework. It examines whether the sale was at arm's length for fair market value and whether the government decision to purchase the company was one where the government acted as a player in the market competing with private investors on equal terms.

Q.14. In the case of a change in ownership other than the privatization of a government-owned company, such as when a privately owned company is sold to another privately owned company or other private entity or to a private individual, does the EC take the position that the SCM Agreement requires the investigating authority to treat an arm's length, fair market value transaction as extinguishing all subsidies that had been provided to the company before it was sold? If the EC's answer is no, please explain. In addition, indicate how, if at all, the treatment required by the SCM Agreement in this situation differs from the treatment required by the SCM Agreement when addressing prior subsidies in the wake of an arm's length, fair market value privatization transaction.

Response of the European Communities:

The investigating authorities must *in all cases* establish the existence of a benefit to the manufacturer, producer or exporter under investigation *during* the period of investigation (POI). Whether the producer has changed and whether the purchaser of those assets has obtained a benefit depends on the circumstances and, in particular, on the terms of the transaction (fair market value, arm's-length transaction). This applies to all producers of merchandise whether privately or

[131] See pages 30781-82 of the Federal Register Notice supplied in Exhibit USA-30 ("A. Purchase of Power Plant").

[132] See pages 30782 of the Federal Register Notice supplied in Exhibit USA-30 ("A. Purchase of Power Plant") (emphasis added).

state owned. Although the present dispute concerns a privatization, an arms-length for fair market value sale of productive assets between two private companies will also not lead to the "pass-through" of prior subsidies, as they will be accounted for in the price paid by the purchaser and therefore remain with the seller. By definition, in an arm's-length fair market value sale, no benefit passes to the buyer.

Q.15. Does the EC's answer to the previous question change depending on whether the sale of the privately owned company is accomplished through a sale of shares versus a sale of assets? Please explain.

Response of the European Communities:

The form of the change in the ownership should not take precedence over the substance, *i.e.* whether there is a new producer on the market which is now operating on non-subsidized capital.

Q.16. Please answer the following questions with regard to a heavily subsidized, privately owned company whose shares are publicly traded and are held by numerous shareholders:

a. If the ownership of the shares in the company were to turn over completely within a period of, for example, three years, would the SCM Agreement require that all of the subsidies bestowed on that company prior to this change in ownership be treated as extinguished? Please explain the EC's answer, and cite to the precise textual language in the SCM Agreement that supports the EC's explanation.

b. If 75 per cent of the ownership of the shares in the company were to turn over within a period of, for example, three years, would the SCM Agreement require that all of the subsidies bestowed on that company prior to this change in ownership, or perhaps only 75 per cent of those subsidies, be treated as extinguished? Please explain the EC's answer, and cite to the precise textual language in the SCM Agreement that supports the EC's explanation.

c. If 50 per cent of the ownership of the shares in the company were to turn over within a period of, for example, three years, would the SCM Agreement require that all of the subsidies bestowed on that company prior to this change in ownership, or perhaps only 50 per cent of those subsidies, be treated as extinguished? Please explain the EC's answer, and cite to the precise textual language in the SCM Agreement that supports the EC's explanation.

d. If 25 per cent of the ownership of the shares in the company were to turn over within a period of, for example, three years, would the SCM Agreement require that all of the subsidies bestowed on that company prior to this change in ownership, or

perhaps only 25 per cent of those subsidies, be treated as extinguished? Please explain the EC's answer, and cite to the precise textual language in the SCM Agreement that supports the EC's explanation.

e. If 10 per cent of the shares in the company were held by one shareholder, and that shareholder had effective control over the company, what treatment would the SCM Agreement require for previously bestowed subsidies if that shareholder were to sell its entire ownership interest in that company? Please explain the EC's answer, and cite to the precise textual language in the SCM Agreement that supports the EC's explanation.

f. If none of the shareholders held more than one per cent of the shares in the company and then one of the shareholders increased its ownership interest to 10 per cent and gained effective control over the company, what treatment would the SCM Agreement require for previously bestowed subsidies if that shareholder were to sell its entire ownership interest in that company? Please explain the EC's answer, and cite to the precise textual language in the SCM Agreement that supports the EC's explanation.

Response of the European Communities:

The situations described by the US relate to daily trading of shares under normal market conditions; in these situations there is no change in the producer but shares representing a very small part of the company's equity are regularly bought and sold at different times by individual investors. This situation is *unrelated* to the dispute before the Panel.

In the dispute before the Panel, the *total* fair market value of the assets (including the outstanding balance of prior subsidies) was evaluated by the purchaser and the seller, and the ownership and control of the assets changed hands in the course of an arm's-length transaction. There is a change in the producer and the investigating authority must examine whether the any benefit under Article 1.1 of the SCM Agreement is conferred on the new producer.

Q.17. In its First Submission (at paragraph 131), the United States sets forth an example involving an unrelated trading company. It says:

> **Here, assume that a heavily subsidized producer sells its products to an unrelated trading company in an arm's length transaction at fair market value, and then the trading company exports the same products. If Article 1.1 or any other provision of the SCM Agreement required the identification of a benefit *continuing* after the original subsidy bestowals, the subsidies previously bestowed on the producer would arguably have to be treated as eliminated because the trading company paid the market price for the products that it later exported.**

According to the EC's reasoning, there would be no benefit to the trading company from those subsidies and, consequently, there would be no subsidies to countervail in the importing country. In this scenario, the result would be irrational, particularly because the competing industry in the importing country would have suffered the same injury regardless of whether the imports came from the trading company or the producer. The SCM Agreement avoids such irrational results by not requiring the identification of a *continuing* benefit.

How does the EC respond to this example?

Response of the European Communities:

The situation described in the "trading company" example in the US First Written Submission (paragraph 131) has nothing in common with an arms-length privatization. Please see the EC response to the hypothetical in our Second Written Submission, at Section II.I.

A countervailing duty investigation of non-recurring capital injections into producers must, in particular, assess the amount of the benefit to those producers. The authorities may seek to offset a subsidy found to exist by imposing duties on their products insofar as they cause injury. The fact that the product is sold at a full market price in the importing country has no effect on the calculation of the benefit conferred on the producer with which we are concerned in this case.

EC Countervailing Duty Law

Q.18. In seeking to better understand the arguments which the EC makes in this dispute regarding the text, context and object an purpose of the SCM Agreement, it is instructive to examine how the EC, in its own countervailing duty practice, implements the SCM Agreement. Indeed, Article 31.3(b) of the Vienna Convention on the Law of Treaties states that, in interpreting a treaty, "[t]here shall be taken into account, together with the context ... (b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation ... ." Accordingly, please answer the following questions:

a. Under the EC's countervailing duty law and practice, does the investigating authority determine whether a subsidy "benefit" within the meaning of Article 1.1 of the SCM Agreement exists as of the time of the subsidy bestowal?

b. Has the EC's countervailing duty law or practice ever been interpreted or applied by the investigating authority to require a determination as to the existence of a subsidy "benefit" within the meaning of Article 1.1 of the SCM Agreement as of any time after the subsidy bestowal? If the EC's answer is yes, please provide an explanation, and cite to the particular provi-

sion of the EC's countervailing duty law, or the EC's practice thereunder, that supports this explanation.

c. Are there any circumstances in which the EC does not allocate the benefits of large or non-recurring subsidies over a period of years? If the EC's answer is yes, please provide an explanation, and cite to the particular provision of the EC's countervailing duty law, or the EC's practice thereunder, that supports this explanation.

d. Are there any circumstances in which the EC changes how it allocates the benefits of large or non-recurring subsidies over a period of years based on events taking place after the subsidy bestowal? If the EC's answer is yes, please provide an explanation, and cite to the particular provision of the EC's countervailing duty law, or the EC's practice thereunder, that supports this explanation.

Response of the European Communities:

Article 31.3(b) of the *Vienna Convention on the Law of Treaties* allows subsequent practice to be taken into account in interpretation together with the context where this establishes an agreement between the parties of the treaty as to its interpretation. This subsequent practice must be "concordant, common and consistent" and must also be common to all the parties[133] and so will be particularly difficult to establish in the case of a multilateral agreement.

Therefore, the European Communities do not consider that an examination of its own countervailing duty practice is instructive in this case. The EC countervailing duty regulations and EC practice in this area are fully consistent with the interpretation of the ASCM that the European Communities are advocating in this case. The European Communities have *never* applied a "pass-through" methodology in its own countervailing duty practice.

Economics of Privatization

Q.19. In its First Submission (at paragraphs 50-66), the EC states that, as an economic matter, an arm's length, fair market value privatization transaction extinguishes previously bestowed subsidies. With regard to the privatization of a company owned by an EU member State government, which is subject to the rules set forth in the State Aids Code, is it the EC's view that, as an economic matter, an arm's length, fair market value transaction extinguishes previously bestowed subsidies?

[133] Sinclair, The Vienna Convention on the Law Treaties (2nd ed., 1984), p. 137; Yasseen, "L'interprétation des traités d'après la Convention de Vienne sur le Droit des Traités" (1976-III).

Response of the European Communities:

> *The European Communities provide a detailed answer with respect to its State Aid Code for the benefit of the Panel and US in its Second Written Submission (see Section II.H).*

Q.20. Please explain the economic theory behind the State Aids Code's treatment of State aid provided prior to a privatization as automatically continuing, in full, to the benefit of the successor company and its owners?

Response of the European Communities:

Please see Second Written Submission of the European Communities, at Section II.H. Under State Aid law, aid granted *illegally* can be recovered from the successor company independent of whether or not the successor company has obtained a benefit or of whether or not the sale was at fair market value in an arm's-length transaction. The granting of non-authorized aid is a breach of the EC law for which the successor company may be held responsible independently of any economic considerations. The US has mischaracterized the EC State Aid law.

Q.21. Does the EC agree that where the government provides massive subsidies to an industry, this subsidization can distort trade by enabling companies in the industry to continue building and modernizing production facilities and producing output even where output exceeds demand? Please explain.

Q.22. Does the EC agree that the excess capacity and excess output resulting from massive subsidization can drive down the value of the companies in this industry as well as the prices of the industry's overall output? Please explain.

Q.23. Does the EC agree that if a particular company in an unsubsidized industry were to be sold, it would command a higher market price than would the same company if the industry were heavily subsidized because there would be no excess capacity or excess output from inefficient, subsidized companies to depress the market price of the company? Please explain.

Q.24. Does the EC agree that even if an arm's length price is paid for a heavily subsidized company in a heavily subsidized industry, the subsidies previously bestowed on that company continue to distort trade, through artificially high output, through artificially low output prices resulting from the excess capacity which they created and through the reduced value of companies throughout the industry? Please explain.

Response of the European Communities:

The European Communities address the US argument in these questions at length in its Second Written Submission, including a detailed response to the US "rich uncle" hypothetical. Please see Section II.F. Some subsidies may have certain effects on the market. The purpose of countervailing duties, however, is to *offset* injurious subsidies within the meaning of the ASCM, not to correct market distortions. When countervailing duties are imposed for reasons other than to offset subsidies, they serve to restrict world trade and become themselves a central instrument of market distortion. The EC would point out that the ASCM does not allow countervailing duties to be imposed where there is no benefit conferred on the producer.

Q.25. In British Steel's 1984/85 Annual Report (at page 23) (see Exhibit USA-32), four years prior to the 1988 privatization of British Steel, the company's auditors expressed "uncertainty" as to whether British Steel would remain "a going concern" without "sufficient finance ... forthcoming to meet ongoing [cash] requirements." Does the EC agree that, but for the U.K. government's massive subsidization, it was likely that British Steel would not have remained a "going concern"?

Response of the European Communities:

The state-owned British Steel Corporation (BSC) was, of course, not the company investigated or reviewed in the investigations subject to this dispute. Further, the auditors did not express uncertainty that BSC would remain a going concern if sufficient finance was forthcoming, as the US falsely suggests in its question ("'uncertainty' ... with sufficient finance forthcoming ... .'"). Rather, as reflected on p. 23 of the BSC Annual Report, the auditors explained that, at the time of their report in July 1985, "there are uncertainties facing steel industries generally, including the continuation of reasonable stability in the European steel market. In consequence, (i) there are doubts as to the level of future trading results and (ii) if the trading conditions are significantly different from those assumed in the projections underlying the external financing limit, the limit set by the Government for the financial year ending March 1986 could prove inadequate."

Whether or not BSC, the state-owned company, would have remained a "going concern" without the subsidies that were provided by the British Government in the 1977-85 period is also a moot and irrelevant question.

The US question incorrectly assumes that if BSC would not have continued as a going concern producing and exporting steel, none of its plants or productive units would have continued in operation producing or exporting steel to the US Not only is there no evidence in the record in this regard, but the premise is contrary to economic logic and experience. Many companies in financial straits do not continue as "going concerns" - but this does not mean that their productive facilities cease to exist. As the experience of countless US companies demonstrates, what happens is that the financial structure of the company is reorganized,

or, if the company is liquidated, its productive facilities that have a positive market value are sold.

Q.26. Does the EC agree that British Steel, immediately prior to its 1988 privatization, was more competitive as a result of the more than £7 billion ($13 billion) in subsidies which it had received from the U.K. government between 1978 and 1988? If the EC's answer is no, please explain the following acknowledgement in British Steel's 1987/88 Annual Report (at page 5) (see Exhibit USA-33) that its competitiveness benefited from recent investment in plant and equipment:

> **The present profit position is the reward for the radical measures taken over the past years to rationalize and restructure the operation of the business, allied with benefits increasingly coming through from well-directed investment in plant and equipment, which together have given us a more competitive base.**

Q.27. Immediately after the 1988 privatization of British Steel, was British Steel more competitive as a result of the more than £7 billion ($13 billion) in subsidies which it had received from the U.K. government between 1978 and 1988? If the EC's answer is no, please explain the statement of British Steel's chairman, immediately after the 1988 privatization of British Steel in its 1988/89 Annual Report (at page 4) (see Exhibit USA-34) that:

> **We are now benefiting from the restructuring programme we have been maintaining in recent years. We have concentrated on a smaller number of efficient sites which have been further improved by well-directed investment. As a result, we have been able to respond to increased demand on the basis of efficient plants operating at high throughput and utilization rates, giving rise to lower costs and efficient margins.**

Response of the European Communities:

The state-owned British Steel Corporation (BSC) was, of course, not the company investigated or reviewed in the investigations subject to this dispute. Further, the quotation from BSC's 1987/88 Annual Report points out that BSC's competitive and position at that time was the result of two major factors: (1) the elimination of excess capacity and the rationalization of productive capacity to better reflect market conditions, and (2) investment that had been made in plant and equipment.

The first factor, which the US chooses to ignore, demonstrates that the aid received by BSC was *not* designed to maintain or create steel-producing capacity that the private market would not have maintained or created, but to eliminate such capacity and to bring BSC's productive facilities in line with market demands - just as would have been achieved if the company had gone through a bankruptcy proceeding.

The US focuses on the second factor, with the unspoken assumption that private investors would not have financed the particular investments in plant and equipment made by BSC during this period. There is nothing in the record to support such an assumption, nor is there any credible evidence that any such improvements would not have been financed by the private sector.

The critical issue in this proceeding is whether, after the market-value privatization of BSC's productive units, the operation of those units in the hands of the new private owners who had paid market value to acquire them continued to benefit from the past financial contributions received by the state-owned BSC. The answer is clearly *no*. If facilities acquired in the 1988 privatization were more modern or efficient as a result of the investments made by BSC with subsidy funds, that fact was reflected in the fair market value price paid in the privatization. As the European Communities have set forth at length, if the plants had been less modern or efficient, the new owners would have paid a lower price. In short, having paid market value for the facilities acquired - including any facilities enhanced by prior investments - the new owners have paid for the value of those investments and are not operating with "improved facilities" that they have not fully paid for.

Although it is irrelevant, the European Communities note that it does not accept the US factual assertions made regarding the amount of countervailable subsidies received by the BSC.

ATTACHMENT 1.5

SECOND WRITTEN SUBMISSION OF THE EUROPEAN COMMUNITIES
(Geneva, 30 June 1999)

TABLE OF CONTENTS

I. INTRODUCTION

1. In both its First Written Submission and Oral Statement to the Panel, the United States has advanced a series of remarkable propositions in support of the actions that are the subject of this dispute. Most notably, the United States contends that the WTO Agreement on Subsidies and Countervailing Measures ("ASCM" or the "Agreement") imposes no obligation that the United States find, on the basis of record evidence, the *existence* of a "benefit" and thus a "subsidy" to the very producer under investigation before it imposes countervailing duties on that producer's goods. After setting aside this fundamental threshold requirement arising out of Article 1.1(b) ASCM, the US *irrebuttably* presumes[134] the existence of such a subsidy. The US claims discretion to do so on the basis that when an unrelated state-owned company received a government financial contribution years ago, the subsidy somehow became "glued to the assets," travelling with them in a unique (and inexplicable) way through an *arm's-length privatization at fair market value* between unrelated parties. In the words of the United States, "the privatization of a government-owned company, *per se*, does not and cannot eliminate this countervailability".[135]

2. Recognizing the difficulty of credibly asserting to the Panel that its imposition of countervailing duties in this situation in any manner "offsets" an existing subsidy to the unrelated and "independent"[136] private producer actually under investigation by the US, the US seeks to redefine the object and purpose of countervailing duties. Countervailing duties are no longer "a *special duty levied for the purpose of offsetting* any subsidy bestowed directly or indirectly upon the manufacture, production or export of any merchandise."[137] Rather, the "real" object and purpose of the ASCM is, according to the US, "*to deter* and offset trade-distorting government subsidies".[138]

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[134] "General Issues Appendix", appended to *Final Affirmative Countervailing Duty Determination; Certain Steel Products from Austria,* 58 Fed. Reg. 37217, 37263 (9 July 1993) ("GIA"). The US authorities' discussion of "privatization" is found at 37259-65. A related discussion of "restructuring" meant to account for the US treatment of "travelling" subsidies to privatized "spin-offs" (other than the company specifically under direct investigation) is contained at page 37265 et seq.. Exhibit EC-2.

[135] "General Issues Appendix", appended to *Final Affirmative Countervailing Duty Determination; Certain Steel Products from Austria,* 58 Fed. Reg. 37217, 37263 (9 July 1993) ("GIA") (emphasis added).

[136] *Final Affirmative Countervailing Duty Determination; Certain Hot Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom,* 58 Fed. Reg. 6237, 6240 (27 January 1993) ["*UK Leaded Bars*"]["*1992 Investigation*"]. See Exhibit EC-4.

[137] Article 10, footnote 36 ASCM; Article VI:3 of GATT 1994 (emphasis added).

[138] US First Written Submission at para. 21 (emphasis added).

3. Thus reading a theory of deterrence into the ASCM, USDOC next seeks to justify the use of countervailing measures to correct alleged "market distortions" it claims are due to subsidy. Even leaving aside the fact that USDOC never established such a market distortion in its investigations of British Steel plc, it is plain that the ASCM provides no basis for the use of countervailing duties to recreate market conditions *ex ante*. Indeed, the US "market correction" claim in the present dispute is also squarely at odds with the provisions of USDOC's General Issues Appendix. For example, while the US suggests to the Panel that its methodology and the duties imposed therefrom "help to remedy … injurious trade distortions"[139], it asserts in the GIA that "[t]he fact that productive capacity may have been created or continues to exist is an irrelevant inquiry beyond the scope of the law".[140] Simply put, there is no basis in the ASCM for the claim that countervailing measures may be imposed for purposes of deterrence.

4. The US also criticizes the European Communities for the claim that recipients of subsidies are legal persons, not inanimate assets. Indeed, the claim that subsidies are given to assets, reside in those assets, and travel with those assets in the event of sale is central to the US position in this dispute.[141] This claim misreads the plain language of Article 10 ASCM, footnote 36 thereto, and Article VI:3 of GATT 1994. Even US law makes plain that subsidies are given to "persons".[142]

5. In addition to its substantive claims, the US asserts that its plainly arbitrary privatization methodology is entitled to deference as one of many "permissible" interpretations under Article 17.6 of the *Antidumping* Agreement.[143] As a threshold matter, it is plain that the appropriate standard of review in this dispute is set forth in Article 11 of the Dispute Settlement Understanding. The United States asks the Panel to ignore the DSU standard, and argues for unprecedented deference to US national courts which, the US claims, have already provided an "independent interpretation" of the ASCM and the consistency of US privatization practice therewith.[144] As detailed below, the standard of review suggested by the US has already been rejected by the Appellate Body as inapplicable, and the US assertion that US courts have undertaken a substantive independent review of the issues before this Panel is false.

6. While the US approach briefly summarized above is understandable in light of the enormous pressure exerted by the US domestic steel industry on US authorities to impede foreign steel imports, the US practice is not consistent with the text of the ASCM, nor with the object and purpose of countervailing duties set forth in Article 10 ASCM and Article VI:3 of GATT 1994. By imposing countervailing duties for the purposes of deterrence where no subsidy exists, the

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139 US First Written Submission at para. 150.

140 See GIA at page 37264.

141 See the repeated US reference to privatization as the mere "change of ownership of the subsidy recipient". US First Written Submission at, *e.g.*, paras. 100,120, 129, 150, 181, and 183.

142 19 USC. §1677(5)(B).

143 See US First Written Submission at paras. 102-104; see also US Oral Statement at paras. 57-60.

144 See US First Written Submission at para. 61.

US has, quite simply, gone beyond the limits of the ASCM. As Brazil noted in its oral statement to the Panel, the US privatization practice has had "widespread adverse effects that extend far beyond the United Kingdom companies involved", with the US having "systematically targeted dozens of companies in countries such as Germany, Israel, Brazil, Italy, Mexico, and the United Kingdom … the exports of these companies have been effectively barred from the United States market".[145] As a result of its attempt to justify a practice which is in direct contravention of the ASCM, the United States, in its oral and written submissions to the Panel, commits serious factual, economic and legal errors. The most significant of these errors are detailed below.

7. This submission is divided into two substantive sections. Section I addresses the limited US response to the fundamental economic principles set forth by the EC and the Third Parties to this dispute. Section II sets forth the EC response to the main legal arguments made by the United States, including:

- the inappropriate standard of review advocated by the US in this dispute and the related US reliance on selected rulings by its own national courts;
- the false characterization of the EC position regarding the existence of a benefit and existence of a subsidy by the US, which has incorrectly asserted that the EC rely on a so-called "use and effects" test;
- the inaccurate assumption by the US that the ASCM allows it to make irrebuttable presumptions that the benefits of a subsidy to a state-owned company flow automatically to the new owners of productive assets after an arm's-length fair market value privatization, without any demonstration whatsoever of a benefit being received by the privately owned company as required by Article 1.1(b) and Article 14 ASCM;
- the US assertion that a "subsidy recipient" can somehow be productive assets themselves rather than the producer/exporter;
- the US claim that the object and purpose of the Subsidies Agreement and countervailing duties is to "deter" subsidization; and
- the US reliance on Article 27:13 Subsidies Agreement and its mischaracterization of the irrelevant EC State Aid rules; the inappropriate use by the US of the "trading company example"; the incorrect US understanding of EC countervailing law and practice; and finally, the inconsistent US view of the relevance and effect of an arm's-length fair market value sale.

[145] Statement by Brazil to the Panel at page 1 (June 16, 1999) (Brazil Oral Statement).

II. THE US POSITION ON THE ECONOMICS OF PRIVATIZATION

8. As a threshold matter, the European Communities must respectfully note that the United States mischaracterizes the EC position regarding the economics of privatization and then debates an economic proposition never asserted by the EC. The European Communities believe their position was set forth with sufficient clarity in their earlier submissions: the US has irrebuttably presumed that an independent private company that purchased production facilities for specialty steel at arm's length for fair market value somehow benefits from financial contributions provided to a former state-owned company. As a matter of basic economic principles, the EC, Brazil, Mexico and a distinguished US economist have noted that this is completely untenable.[146] Yet, the US ignores the fact that the EC position is limited to market value transactions occurring at arm's length, and falsely informs the Panel that the European Communities advocate the complete extinguishment of any prior subsidies "whenever" a company changes hands under any circumstances.[147] As the Panel is well aware, the European Communities have made no such suggestion.

9. The economics of privatization are important in this dispute because establishing and assessing "benefit", a fundamental requirement for all Members under the ASCM, is an economic inquiry. Without the existence of a benefit, there is no subsidy. Without the existence of a subsidy, countervailing duties may not be imposed.

10. In their First Written Submission, the EC noted:

> [W]hen a private buyer purchases a company or assets thereof in an arm's-length transaction at market value, the price paid necessarily values and incorporates within the transaction any subsidy previously conferred. If the subsidy increases the value of the company, so will it increase the price that the purchaser must pay. The payment of market price thus necessarily precludes the notion that any "benefit" would have "passed through" to this new private owner as a basic matter of economics.[148]

Markets value companies efficiently. This is not open to serious economic dispute - the *fair market value arm's-length* buyer receives *no* benefit from a subsidy provided to a former state-owned enterprise in such a situation. The US has not challenged this fundamental economic proposition, instead preferring to argue that it is under no obligation to determine that the firm under investigation

[146] See, *e.g.*, First Submission of the European Communities at para. 50.

[147] For example, the US claims the European Communities want the Panel to conclude that subsidies are "automatically" extinguished, that the European Communities are promoting a "loophole", "namely the extinguishment of subsidies *whenever* the ownership of a subsidized company changes hands", that the EC "assumes away" government subsidization, and that the "EC's approach to privatization basically calls for the extinguishment of all prior subsidies". See US First Written Submission at para. 220 and US Oral Statement at paras. 9, 34, 77 and 79.

[148] EC First Written Submission at para. 50.

was the "actual recipient", or otherwise benefits from subsidy, before it imposes countervailing duties.[149]

11. The European Communities have identified three claims of an economic nature advanced by the US in support of its practice: (1) because subsidies are "glued" to assets, "subsidized production" continues even after an arm's-length fair market value privatization[150,] (2) because state-owned enterprises were subsidized and such subsidies may have caused a market distortion, the US may use Part V ASCM to address those past or present distortions, as well as deter subsidies, by imposing countervailing duties on companies that bought state-owned enterprises or productive units thereof[151], and (3) because the state-owned British Steel Corporation (BSC) received significant subsidies in the 1970s and 1980s, those subsides must have benefited the company's purchaser in some manner.[152] Each of these arguments lacks economic merit.

12. First, the US makes no economic showing that subsidies are somehow glued to assets or that the purchaser of assets has in any manner benefited from a reduced cost or enhanced revenue as a result of its purchase of those assets at *arm's length for fair market value*. It cannot make such showing, because the company demonstrably enjoys no benefit.

13. Second, seeking to avoid the requirement that it must establish a benefit before imposing countervailing duties, the US argues that this focus is insufficient as it will not address "market distortions".[153] In this way, the US simply abandons the requisite benefit analysis. Instead, as addressed more fully in Section II below, the US attempts to assert that the ASCM authorizes Members to "deter" subsidies through countervailing duties in an effort to re-create the *status quo ante*. This is simply not correct.

14. Third, the United States seeks to focus the Panel solely on the receipt of subsidies by the state-owned British Steel Corporation, an approach, in our view, that amounts to trying to change the subject. That the *British Steel Corporation* (BSC) received government financial contributions that conferred a benefit to that *State Corporation* has never been in dispute.[154] But BSC last produced steel in 1988, and neither BSC nor its products were the subject of the relevant USDOC investigation or reviews. By deeming the existence of a benefit relevant only with regard to an unrelated former state-owned corporation (BSC) and then automatically imputing that benefit to an unrelated fair market value purchaser, the US is countervailing the goods of a producer without ever examining whether that producer is indeed benefiting from a financial contribution during the relevant period of review.

15. As noted in the European Communities' oral statement, both the EC and the Third Parties have already offered the Panel extensive comments and exam-

[149] US First Written Submission at para. 182.
[150] Ibid. at para. 214.
[151] Ibid. at paras. 214-216.
[152] See, *e.g.*, US Oral Statement at paras. 18 and 82.
[153] See US First Written Submission at para. 224.
[154] EC First Written Submission at para. 131.

ples on why the US automatic "travel with the assets" approach ignores economic reality. In addition, since the EC's First Written submission, a noted international economist, Professor Richard N. Cooper of Harvard University[155], has also addressed the issue in comments provided to the US authorities in this dispute. His economic analysis for the US Consumers for World Trade ("CWT") directly addresses the issue of whether prior subsidies to a state-owned enterprise confer any economic benefit "to a company, a productive unit of a company, or the merchandise produced by that company" after a fair market value privatization.[156] Dr. Cooper comments:

> Basic economic analysis establishes that *no* economic benefit is enjoyed by the now-privatized producer of the goods, a productive unit thereof, or the merchandise itself, in comparison to competitors in the marketplace ... DOC deems the issue of whether or not the sale of a state-owned company was for fair market value *irrelevant* to its calculation of CVD's on the merchandise of the now-privatized company. From the perspective of analyzing whether any benefit is enjoyed by the privatized company, however, *this inquiry is the most fundamental issue* ... US countervailing duty practice ensures that countervailing duties will be assessed as *financial penalties* on privatized firms that enjoy *no economic benefit* from government contributions provided to state-owned predecessors. In these situations, the US is not countervailing any economic benefit conferred on goods crossing our borders. The practice must be seen as *purely protectionist* on behalf of US domestic firms in competition with the newly privatized firms.[157]

16. While the US informs the Panel that its repayment methodology is "sensible, logical and reasonable"[158], the European Communities respectfully submit that even a cursory examination demonstrates that the methodology is irrational and arbitrary. The methodology makes no analysis of the existence of a "benefit" after a fundamental change in circumstances has occurred, such as a privatization, for the private company under investigation. It relies on assumptions directly contradicted by record evidence, treating as "irrelevant" such central issues as whether the purchaser paid fair market value. Contrary to express US assurances that it "pays particular attention to the facts of each case"[159], the US practice is entirely formulaic, based on application of a self-derived pseudo-scientific "gamma" to one portion (the cash portion) of the total purchase price. USDOC irrebuttably labels the resultant sum a "credit" for prior subsidies. (In the case of

[155] As noted in Exhibit EC-13, Dr. Cooper has served as Chairman of the Federal Reserve Bank of Boston, Undersecretary of State for Economic Affairs in the US State Department and Senior Staff Economist for the Council of Economic Advisors.
[156] Dr. Cooper' s analysis, which was published by CWT on the Internet (see http://www.cwt.org/), has been submitted to the Panel as Exhibit EC-13.
[157] Emphasis added.
[158] US Oral Statement at para. 5.
[159] US Oral Statement at para. 46.

a spin-off, USDOC "allocates" subsidy between seller and purchaser.[160]) In no instance does USDOC ever examine whether a benefit was conferred on the purchaser or whether the transaction occurred at arm's-length for fair market value. The result is the imposition of countervailing duties in amounts meant to penalize market value purchasers for not paying far above the entire market value of the productive assets at issue.[161]

17. The USDOC methodology lacks any rational economic basis as a means to assess the existence of a benefit and thus the existence of a subsidy prior to the imposition of a countervailing duty. As Professor Cooper concludes:

> [W]hile DOC openly expresses its view that privatization "affects" previous subsidies, its current methodology to account for this event bears no relation to the economics of the privatization itself or to an economic analysis of whether any benefits are conferred on production of the now-private firm ... Th[e DOC repayment calculation] is an *arbitrary* calculation.
>
> The DOC calculation of residual past subsidies following privatization *makes no economic sense*. It is at odds with policies championed by other segments of the US Government, such as the US Departments of Treasury and State ... The *arbitrary and transparently absurd methodology* of the DOC will go far to discredit the frequently professed claim that the US Government favours and practices fairness in its trade policies.[162]

18. The US refusal to take into account whether the sale of a government-owned company occurred at arm's length for fair market value is unreasonable and economically irrational. The US ignores whether any benefit was conferred on the buyer and new owner of the productive assets. In the words of Professor Cooper, this "makes no economic sense." The European Communities again respectfully submit that this practice violates the ASCM requirements under Articles 10 and 19 that the existence of a benefit and thus the existence of a subsidy first be established with regard to the company under investigation, before the goods of that company are assessed countervailing duties.

19. Policymakers around the globe have come to recognize the importance of privatization of state-owned enterprises as a means of achieving economic rationalization and more efficient allocation of the world's resources. The US approach, however, has a significantly negative effect on privatization efforts throughout the world. Were the US approach applied by all WTO Members, it would erect unwarranted barriers to trade and deter those governments which are considering privatizing state-owned companies from doing so. The US approach unfairly

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[160] US First Written Submission at para. 54. The Richemont plant cited by the US in its oral statement was accorded spin-off treatment as it was not the company DOC was investigating. See discussion of Richemont, below. Under its automatic formula, DOC made *no* assessment of whether a benefit was conferred to the purchaser of the productive unit. See also EC's Response to question 3 from the Panel.

[161] See also First Written Submission of the Government of Brazil at paras. 87-92.

[162] Emphasis added.

punishes private companies and restricts exports with "countervailing" duties in the complete absence of any countervailable benefit to offset. The European Communities are of the opinion that the US practice is contrary to the world trade order. It should not be followed by other WTO Members and should be abandoned by USDOC immediately.

III. LEGAL ARGUMENT

A. The Appropriate Standard of Review for this Dispute is Article 11 of the Dispute Settlement Understanding (DSU), not Article 17.6 of the Antidumping Agreement

20. In both its written and oral submissions to the Panel, the US has stated that the standard of review applicable to this dispute is Article 17.6 of the Antidumping Agreement. Under this proposed standard, the US claims entitlement to an unwarranted measure of deference for actions it deems "permissible", apparently hoping to avoid close examination of those practices by the Panel.[163] For the reasons outlined below, however, the Panel may not accord any deference to the US actions that are the subject of this dispute.

21. Article 30 ASCM sets forth that the terms of the DSU apply to the settlement of all disputes under the ASCM. Under the terms of the DSU, the Panel must determine "whether there is an infringement of obligations assumed under a covered agreement,"[164] "in accordance with customary rules of interpretation of public international law."[165] Article 11 DSU sets forth the standard of review required of panels[166] and should guide the Panel in this dispute:

> The function of panels is to assist the DSB in discharging its responsibilities under this Understanding and the covered agreements. Accordingly, *a panel should make an objective assessment*

[163] As Professor John Jackson, one of the world's leading WTO scholars, has explained, the extreme deference sought by the United States for its actions is not warranted even under an Article 17.6 standard of review. See Steven P. Croley & John H. Jackson, *WTO Dispute Procedures, Standard of Review, and Deference to National Governments,* 90 Am. J. Int'l L. 193 (1996). Based on a detailed review of Article 17 AD Agreement and the Vienna Convention, Professor Jackson notes that the purpose of the Vienna Convention is to help resolve any ambiguities in the text. The range of "permissible" interpretations advanced by the US will rarely be relevant because there usually will not be "more than one permissible interpretation" under Article 17.6. Analyzing the US domestic *Chevron* decision which was the model for US negotiators in proposing what became Article 17.6(ii), Professor Jackson illustrates why none of the rationales for deference to administrative agencies that apply to DOC's benefit in US legal proceedings are relevant in the context of WTO panel reviews. No WTO Member has any greater expertise relative to other WTO Members regarding the interpretation and application of provisions of the Agreement - they are "interested parties whose own interests may not always sustain a necessary fidelity to the terms of international agreements." Ibid. at 209.

[164] Article 3.8 DSU.

[165] Article 3.2 DSU.

[166] The panel in *Argentina- Safeguard Measures on Imports of Footwear* ("Argentina – Footwear (EC)") confirmed that Article 11 DSU establishes the appropriate standard of review with respect to disputes under covered agreements. WT/DS121/R, Report of the Panel, adopted 12 January 2000, as modified by the Appellate Body Report WT/DS121/AB/R, DSR 2000:II, 575, para. 8.124.

> of the matter before it, *including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements*, and make such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements. Panels should consult regularly with the parties to the dispute and give them adequate opportunity to develop a mutually satisfactory solution.[167]

22. No equivalent to Article 17.6 of the Antidumping Agreement is found in the text of the ASCM. Indeed, while the Article 17.6 standard was purposely included in the AD Agreement, it was purposely excluded from the ASCM. As both Brazil and the US have noted, the inclusion of one is the exclusion of the other (*inclusio unius est exclusio alterius).* If negotiators had intended the ASCM to have a standard of review similar to that found in Article 17.6 AD Agreement, the negotiators would surely have included it. They did not, and instead issued the *Decision on Review of Article 17.6 of the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994*:

> The standard of review in paragraph 6 of Article 17 of the Agreement on Implementation of Article VI of GATT 1994 shall be reviewed after a period of three years with a view to considering the question of whether it is capable of general application.

The Decision makes clear that Members have yet to decide whether Article 17.6 is capable of application outside the AD Agreement.[168]

23. In the *Hormones* case, the US cited to the *Decision on Review of Article 17.6* in support of the proposition that Members have yet to decide if the standard of review set out in Article 17.6 of the AD Agreement is applicable elsewhere.[169] In its decision in *Hormones*, the Appellate Body was clear: "The Ministerial Decision evidences that the Ministers were aware that Article 17.6 of the Anti-Dumping Agreement *was applicable only in respect of that Agreement*."[170]

24. Despite the decision of the Appellate Body in the *Hormones* case, the US asserts that the Panel should apply an Article 17.6 standard in countervailing duty cases solely as a result of the *Declaration on Dispute Settlement Pursuant to the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 or Part V of the Agreement on Subsidies and Countervailing Measures* ("Declaration"). As the Government of Brazil correctly notes, the very

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[167] Emphasis added.

[168] The Note by the Secretariat, Committee on Trade and Development, *A Description of the Provisions Relating to Developing Countries in the Uruguay Round Agreements, Legal Instruments and Ministerial Decisions* comments on the *Decision on Review of Article 17.6* that "Ministers decided that the standard of review - i.e. the scope of analysis and judgement of any panel established under the DSB on anti-dumping cases - will be reviewed in three years with a view to considering whether it is capable of general application (more specifically in the case of countervailing duties)." (COM.TD/W/510).

[169] Appellate Body Report, *EC –Hormones, supra*, footnote 103, para. 42.

[170] Ibid., para. 114, footnote 79 (emphasis added). The *Hormones* dispute concerned the application of Article 17:6(i) AD Agreement. There is no reason that different analysis should apply to the application of Article 17:6(ii) AD Agreement.

existence of the Declaration demonstrates that Members have noted there is a disparity between the standard of review set forth in the ASCM and that provided for in the AD Agreement. Further, the European Communities do not view the Declaration as "meaningless," as the US alleges.[171] It was made in conjunction with the *Decision on Review of Article 17:6,* and serves to outline the desirability of consistent rules for the Members at the time *when* they review the application of Article 17.6. Members have yet to make any decision in this regard, and, given the US practice with regard to Article 17.6, they may collectively decide on some other uniform standard. The Declaration is also not addressed to the Panel, as it is not a covered agreement since it is not listed in Appendix 1 to the DSU. The Declaration therefore falls outside the scope of Article 11 DSU.

25. Recognizing the infirmities in its contentions regarding Article 17.6, the United States, in its oral statement during the First Substantive Meeting with the Panel, has suggested that the Panel turn to selected pre-WTO antidumping and countervailing duty panel determinations.[172] Given that the DSU is clearly applicable to this dispute, the pre-WTO cases cited by the US are irrelevant. Furthermore, even if they were relevant, they concern only technical factual calculations by national authorities in areas in which the relevant GATT codes were silent. As such, they are particularly lacking in relevance here, where a fundamental precept of the ASCM is at issue. The first decision cited by the US is *United States - Imposition of Countervailing Duties on Imports of Fresh and Chilled Atlantic Salmon from Norway,* a Tokyo Round Subsidies Code determination whose terms of reference were restricted explicitly to that agreement.[173] As the European Communities noted during their concluding oral presentation, it is therefore not even a GATT 1947 case. In *United States-Salmon,* the panel found no grounds for ruling US practice inconsistent with the Subsidies Code, which was silent on the applicable details of how Members should calculate secondary tax effects of payroll tax reductions and the interest rate benchmark for measuring the benefits from certain loan programmes. The second case cited by the US, *New Zealand Electrical Transformer*[174], is an *antidumping* panel report. Again, apart from its irrelevance given the obligations and standard set forth in the DSU, that case involved a panel faced with no agreed GATT rules on how to calculate cost of production and evidence of a "highly technical nature" concerning the cost of production for sophisticated custom-built electrical transformers used by utility companies. In the light of the lack of clear guidance regarding cost of production, the panel "considered that there was no basis on which to disagree with the New Zealand authorities finding of dumping.[175]

26. In contrast, the present case does not involve complex facts and technical evidence. Rather, it concerns the fundamental issue of whether the ASCM re-

[171] US Oral Statement at para. 60.
[172] US Oral Statement during First Substantive Meeting with the Panel, at para. 62.
[173] *United States - Imposition of Countervailing Duties on Imports of Fresh and Chilled Atlantic Salmon from Norway,* SCM/153, Report of the Panel adopted on 4 December 1992.
[174] *New Zealand - Imports of Electrical Transformers from Finland,* L/5841 - 32S/55, Report of the Panel adopted on 18 July 1985.
[175] Ibid., para. 4.3.

quires that a "benefit" must be found before a subsidy can exist. Indeed, notwithstanding the clear application of the DSU, if any pre-WTO panel reports should be considered as regards this issue, the European Communities respectfully suggest that it would be the 1994 *Leaded Bars* report which, while unadopted, recognized the "pass though" issue as legal, not simply technical in nature, and therefore one cognizable under the Subsidies Code.[176]

27. Finally, even the inapplicable Article 17.6 (ii) standard of review would afford no deference to the practices of USDOC authorities in this dispute. This provision reads as follows:

> The panel shall interpret the relevant provisions of the Agreement in accordance with customary rules of interpretation of public international law. Where the panel finds that a relevant provision of the Agreement admits of more than one permissible interpretation, the panel shall find the authorities' measure to be in conformity with the Agreement if it rests upon one of those permissible interpretations.

Accordingly, deference would be appropriate under that standard only if the ASCM, once interpreted in accordance with the customary rules of interpretation of public international law "admits of more than one permissible interpretation" on the issues in dispute. Nothing could be further from the truth. The ASCM is not "silent[177], as the US claims, on the fundamental obligation of a Member to establish the existence of a subsidy to the company under investigation prior to imposing countervailing duties on its merchandise (see Article 19 ASCM). Nor is the Agreement "silent" on the appropriateness of assessing countervailing duties on a company which has received no benefit to offset (Article 1, 10 ASCM). It is true that the EC and the US are advancing different interpretations of these provisions. But this is not a reason for allowing each party to adopt its own interpretation. The very purpose of applying the customary rules of interpretation of public international law is to *resolve* differences of view of interpretation and to arrive at a *single correct* interpretation.[178] Thus, the Article 17.6 (ii) standard - even if applied - would afford no deference to the contested US practices.

28. In sum, the task of the Panel is clear. It should apply the relevant provisions of the DSU in its review of this dispute, including the customary rules of interpretation of public international law, making an objective *assessment of the matter before it*, including *an objective assessment of the facts* of the case and the *applicability of and conformity with the ASCM*. No other standard of review is applicable to the deliberations of this Panel.

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[176] *United States - Imposition of Countervailing Duties in Certain Lead and Bismuth Carbon Steel Products Originating in France, Germany and the United Kingdom*, Report of the Panel (unadopted).

[177] See US Oral Statement at para. 58.

[178] See Steven P. Croley & John H. Jackson, *op. cit.* footnote 30.

B. The US has Mischaracterized the Determination of its Courts and the Panel Should Accord no Relevance to their Conclusions in its Independent Analysis of the Consistency of US Actions with the ASCM

29. The US statement that its court decisions "represent an independent interpretation of a countervailing duty law that is indistinguishable from the ASCM in the areas relevant to this matter" is false.[179] The Panel should reject the US attempt to encourage the Panel to rely on the fact that a US appeals court has allowed USDOC pre-privatization practice to this point.

30. USDOC acts under delegated authority from the US Congress in administering the US countervailing duty laws. Therefore, *any* analysis by a US court concerning how USDOC treats the issue of privatization and the existence of countervailable subsidies must be addressed in the context of the US Congress' intent in its enactment of the Uruguay Round Agreements Act ("URAA").[180] As cited in the EC's First Written Submission, the URAA provides:

[a] change in ownership of all or part of a foreign enterprise or the productive assets of a foreign enterprise does not by itself require a determination by the administering authority that a past countervailable subsidy received by the enterprise no longer continues to be countervailable, even if the change in ownership is accomplished through an arm's length transaction.[181]

31. This provision does not of course correspond to anything in the ASCM and its presence is already sufficient to refute the US argument that its law is indistinguishable from the ASCM. Indeed, the fact that it was considered necessary at all demonstrates that, contrary to what it now claims, the US did not read the ASCM as allowing it to apply its "pass-through" doctrine.

32. The Statement of Administration Action ("SAA") to the URAA, which represents the "authoritative expression by the Administration concerning its views regarding the interpretation and application of the Uruguay Round Agreements, both for purposes of US international obligations and domestic law"[182] explains:

> Section 771(5)(F) provides that a change in the ownership of "all or part of a foreign enterprise" (*i.e.*, a firm or a division of a firm) of the productive assets of a firm, even if accomplished through an arm's-length transaction, does not by itself require Commerce to find that past countervailable subsidies received by the firm no longer continue to be countervailable. . . Section 771(5)(F) is being added to clarify that the sale of a firm at arm's-length does not automatically, and in all cases, extinguish any prior subsidies conferred. Absent this clarification, some might argue that all that

[179] US First Submission at para. 61.
[180] Uruguay Round Agreements Act, Pub. L. No. 103-465, 108 Stat. 4809 (1994).
[181] URAA Section 771(5)(F); 19 USC. § 1677(5)(F).
[182] Statement of Administrative Action, accompanying H.R. 103-5110 (1994), reprinted in 1994 USC.C.A.N. 3773, 4040.

> would be required to eliminate any countervailing duty liability would be to sell subsidized productive assets to an unrelated party. Consequently, it is imperative that the implementing bill correct and prevent such an extreme interpretation. The issue of privatization of a state-owned firm can be extremely complex and multifaceted. While it is the Administration's intent that Commerce retain the discretion to determine whether, and to what extent, the privatization of a government-owned firm eliminates any previously conferred countervailable subsidies, Commerce must exercise this discretion carefully through its consideration of the facts of each case and its determination of the appropriate methodology to be applied.[183]

33. These provisions are found nowhere in the ASCM and they were not included in the initial Uruguay Round implementing legislation proposed by the US Administration to its Congress. Rather, according to a US participant involved in the URAA and SAA drafting process, the idea of including specific language in the URAA and SAA to express a US view concerning changes in ownership was first presented to several US congressional staff by attorneys representing US domestic steel, lumber and semiconductor industries.[184] In a detailed memorandum to the key congressional officials responsible for the implementing legislation, counsel for the US domestic steel industry noted:

> The proposals released by the Administration to amend the US countervailing duty (CVD) law and implement the SCM Agreement are wholly inadequate ... Legislation must address … the incorrect notion that changes in ownership … of a firm producing the merchandise change the subsidy ... *The fact that the new owners are not subsidized is irrelevant because the production of their facility is*.[185]

Only later was the URAA and SAA language eventually adopted in the US presented by authorities representing the US Administration.[186] As a result of their lobbying efforts, the domestic US steel industry was successful in its effort to ensure the "change in ownership amendment" was included as a part of the URAA and SAA.

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[183] SAA at 928 (1994), reprinted in 1994 USC.C.A.N. 3773, 4240.

[184] David A. Codevilla, *Discouraging the Practice of What We Preach: Saarstahl I, Inland Steel and the Implementation of the Uruguay Round of GATT 1994*, 3 Geo. Mason Independent L. Review 435, at n. 13 (1995) ("At this briefing for Finance Committee staffers, attorneys representing the steel industry described the omission of a 'change in ownership ' amendment to the Administration's initial legislative proposal as 'the biggest loophole' in the implementing bill. They also specifically criticized the Court of International Trade's economic reasoning in *Inland Steel and Saarstahl I*."). Ibid. at n. 171.

[185] Memorandum from John Ragosta, Esq. of Dewey Ballantine LLP to Congressional Staff, *Administration Proposals On Key CVD Issues Are Inadequate and Must Be Revised*, June 29, 1994, at page 1. Exhibit EC-14.

[186] Codevilla at n. 13.

34. That the US privatization language in both the URAA and accompanying SAA is conspicuously absent from the text of the ASCM is, of course, inconsequential to a US court. From a US court's perspective, in exercising its discretion in implementing Section 771(5)(F), USDOC must do so in faithful observance *of Congress' intent, not* the ASCM, which is irrelevant to the reviewing court. Under the *Chevron* standard of review of an agency's (*e.g.*, USDOC 's) interpretation of a statute entrusted to its administration,

> [i]f the intent of Congress is clear ... the court ... must give effect to the unambiguously expressed intent of Congress. If, however, ... the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute.[187]

35. This US Supreme Court ruling has led to the so-called *Chevron* two-step analysis utilized by US courts in reviewing administrative determinations such as those made by USDOC with regard to privatization. Under *Chevron* step one the court asks "whether Congress has directly spoken to the precise question at issue."[188] If so, then the court "*must* give effect to the unambiguously expressed intent of Congress."[189] If the Congress has not addressed the issue, however, then under *Chevron* step two the court must determine whether the agency's interpretation of *the Congressional statute* is merely reasonable. *Id.*

36. In light of the carefully constricted *Chevron* analysis mandated for US court review of USDOC decisions, the US assertion that its court decisions "represent an independent interpretation" of the US CVD law and the "indistinguishable" ASCM is, at best, disingenuous. Under *Chevron*, the courts do not render an independent interpretation of the ASCM - they are only addressing US laws passed by Congress and implemented by USDOC.[190] As the US Court of Appeals for the Federal Circuit notes in one of the very opinions cited by USDOC:

> Commerce's construction *must* be sustained if it falls within the range of permissible construction [of the Congressional statute] ... The duty of the reviewing court is not to weigh the wisdom of, or to resolve any struggle between, competing views of the public interest, but rather to respect legitimate policy choices made by the agency in interpreting and applying the [Congressional] statute ... To sustain an agency's interpretation of a statutory term, we need not find that its construction is the only reasonable one, or even

[187] *Chevron USA., Inc. v. Natural Resources Defense Council, Inc.*, 467 US 837, 842-43, 104 S.Ct. 2778, 2781-82, 81 L. Ed. 2d 694 (1984) (footnotes omitted).
[188] *Chevron*, 467 US at 842.
[189] Ibid. at 843 (emphasis added).
[190] As Section 102(a)(1) of the URAA provides: "UNITED STATES LAW TO PREVAIL IN CONFLICT - No provision of any of the Uruguay Round Agreements, nor the application of any such provision to any person or circumstance, that is inconsistent with any law of the United States shall have effect."

> that it is the result we would have reached had the question arisen in the first instance in judicial proceedings.[191]

37. While suggesting to the Panel in this dispute that US courts have independently affirmed the conformity of USDOC practice with the ASCM, US authorities have expressed a different viewpoint in their own submissions to US courts, pressing for an extreme level of deference to USDOC interpretation of the US statute. In the appeal of the sole post-URAA US appeals court challenge to USDOC's privatization methodology, USDOC notes that:

> [E]ven though *Saarstahl II* and later *British Steel III* both construed the pre-URAA countervailing duty statute, those decisions continue to support Commerce's approach to privatization under the post-URAA statute. None of the provisions added to the statute by the URAA alters the principles on which Commerce 's methodology is based.[192]

38. The US authorities then instruct the US appeals court that it is to accord "*great deference* to the interpretation given the statute by the officers or agency charged with its administration."[193] USDOC informs the court that *Chevron* "*requires the court to defer* to the agency's interpretation of its own *statute* as long as that interpretation is reasonable."[194] Finally, attempting to ensure a standard of US court review favorable to its position, USDOC reminds the court that it should " accord Commerce an even greater deference when reviewing, as here, Commerce's development and application of a complex methodology for use in a ... countervailing duty determination."[195]

39. The purpose of the United States' attempted use of the *Chevron* standard is clear. At the same time it has argued to US courts that it is entitled to "great deference" in its interpretation of the US statute and SAA, it has asserted to the Panel that US court decisions represent an "independent" interpretation of the "indistinguishable" ASCM. In combination with its argument that Article 17.6 of the Antidumping Agreement somehow applies to the ASCM, the US is seeking to avoid *any* independent review by any competent authority of USDOC's practice.

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[191] *Saarstahl AG v. United States*, 78 F.3d 1539, 1541 (Fed. Cir. 1996) (citations and quotations omitted) (emphasis added).

[192] Brief of Defendant-Appellee United States at 15, *Delverde SrL v. United States* (Fed. Cir. Apr. 27, 1999) (No. 99-1186). In its brief, the DOC drew the same conclusion it asserted prior to the entry into force of the ASCM, claiming that:

> [W]ith regard to the "subsidy" requirement, it is sufficient merely to establish that a subsidy was bestowed on the government-owned company prior to privatization. It is not necessary to determine whether or to what extent that company may be benefitting from the subsidy after privatization.

Ibid. at 14-15.

[193] Brief of Defendant-Appellee United States at 32, *Delverde SrL v. United States* (Fed. Cir. Apr. 27, 1999) (No. 99-1186) (citations omitted) (emphasis added).

[194] Brief of Defendant-Appellee United States at 33, *Delverde SrL v. United States* (Fed. Cir. Apr. 27, 1999) (No. 99-1186) (citations omitted) (emphasis added).

[195] Brief of Defendant-Appellee United States at 33, *Delverde SrL v. United States* (Fed. Cir. Apr. 27, 1999) (No. 99-1186) (citations omitted).

The Panel should respectfully reject this attempt, conducting the full and thorough review mandated by the DSU.

C. The European Communities have never Suggested Application of a "Uses" or "Effects" Test

40. In both its First Written Submission and its oral remarks to the Panel, the United States has argued that the European Communities are championing an inquiry into the "uses or effects" of subsidies. The US claims the EC would require such an inquiry "on a *continuing* basis".[196] According to the United States, if it adopts the EC's "proposed effects inquiry", the Panel would be "making a fundamental change in the SCM Agreement's approach to the identification of subsidies".[197] Moreover, the US states, any such inquiry would be fruitless for it would require "an extensive econometric analysis" which "at best, it would be administratively infeasible to undertake ... [and at worst] would be an expensive, resource-intensive exercise that would still be subjective..."[198]

41. The US sorely mischaracterizes the views of the European Communities. The European Communities are not advocating a "uses or effects" test under Article 1 ASCM and has never taken any such extreme position.[199] The sole effects test set forth in the ASCM concerns the Article 15 determination of injury. The parade of horribles set forth by the United States simply has no bearing on the Article 1 inquiry at issue.

42. The European Communities are of the view that WTO Members have an ongoing obligation to ensure that they impose countervailing duties *only* on a producer of merchandise who is benefiting from a financial contribution and in no other circumstance. A Member may not blindly assume that a private firm during an investigation period benefits from a financial contribution received by an unrelated, prior state-owned firm. Rather, a Member must inquire whether - and justify its position that - a past financial contribution to that unrelated firm provides current benefit to the producer (or manufacturer or exporter) at issue with respect to the product then under investigation.[200] It is the European Communities' view both that such an inquiry is required under ASCM Articles 1 and 14 and that no subsidy may lawfully be found to exist where, as here, the state-owned firm in question was sold in an arm's-length fair market value transaction. As we have emphasized above, in an arm's-length fair market value transaction, any benefit that may once have been enjoyed by the state-owned firm has been fully paid for by, and thus cannot "pass through" to, the new private company. Hence, no basis exists for imposing duties on the products of that private firm.

43. The US appears to argue in its defence that the ASCM does not require the revisiting of a benefit already established and supplements this by putting

[196] US First Written Submission at para. 23 (emphasis in original).
[197] Ibid. at paras. 23, 38, 39, 41, and 43.
[198] Ibid. at para. 49 and note 31.
[199] See also Third Party Submission of Brazil at paras. 40-49.
[200] See ASCM, Article 10 and footnote 36.

forward a claim of administrative convenience. In that respect, the US is wrong on both fronts: First, as explained immediately above, the issue is not one of re-visiting, re-doing, or performing an additional benefit analysis as the US seems to claim; rather, it is one of establishing directly the benefit with regard to the company under investigation for the period of investigation. Thus, the starting point of the analysis can only be the producer being investigated, and it is with regard to this producer that a benefit analysis has to be undertaken. To make a benefit analysis with regard to another state-owned producer and prove that a benefit had been granted in the past to **that** producer is irrelevant with regard to the current producer. Thus, USDOC, by focusing for the purpose of its benefit analysis on the wrong producer (the state-owned company) rather than the producer actually investigated, has come to erroneous conclusions and the consideration that focusing on the current producer amounts to a second benefit analysis.

Secondly, the US conjectures that introduction of an "additional" benefit analysis would prove administratively overwhelming. There is nothing administratively overwhelming about abiding by the clear mandate of the ASCM that Members examine whether a company under a current countervailing duty investigation or review currently benefits from a government financial contribution. The tools for this inquiry are set forth in the Agreement. Moreover, USDOC has performed an analysis of whether a transaction was at arm's length and at a fair market value in a recent case in the context of a sale. This is detailed below at Section II.K discussing the Richemont sale. There is nothing on the record to indicate that the said analysis was particularly cumbersome or that it could not have been performed within the time limits of a countervailing duty investigation. If the investigating authorities were to find that the transaction took place at arm's-length and at fair market value, they would necessarily have to conclude that no "benefit" existed and thus no countervailing duties could be imposed on the purchaser's goods.

D. Untied Subsidies Are Conferred on Producers and Do Not Reside in Assets or Production or Merchandise

44. In the view of the European Communities, the ASCM precludes a Member from imposing countervailing duties on the importation of merchandise that is manufactured, produced, or exported by a private company that has never *itself* received a subsidy without a determination that the private company - and hence the merchandise it manufactures, produces, or exports - is presently benefiting from financial contributions provided pre-privatization to a then state-owned firm.

45. By contrast, the United States submits that no such determination is necessary. An essential feature of the US position in this dispute is that subsidies are conferred not on companies or legal persons, but on assets. Under this novel view, subsidies become imbedded in assets and then "travel to their new

home."[201] Thus, in the US view, once a subsidy "resides" in an asset, it will remain glued there until the end of the appropriate allocation period, regardless of subsequent developments, including fundamental changes of circumstances, such as a privatization at arm's length at fair market value. This will be true regardless of who owns the asset, or how much has been paid to purchase it.

46. The US case rests on an interpretation of footnote 36 ASCM and Article VI:3 of the GATT 1994, which provide, in relevant part, that subsidy is "bestowed ... upon the manufacture, production or export of any merchandise." The US reads this provision as indicating that subsidy is given to a productive asset; hence, throughout its First Written Submission, the US speaks of privatization as a simple "change in ownership of the subsidy recipient".[202]

47. The European Communities submit that there is no logical basis for reading these provisions as providing that plants or assets or productive units are themselves the recipients of an untied subsidy. In our view, footnote 36 ASCM and Article VI:3 of the GATT 1994 as properly understood are providing that financial contributions benefit the *act* of production, manufacture, or export. Financial contributions provide an advantage for economic activities carried on by business enterprises. They are received by legal persons, not inanimate objects. Steel rolling machines do not have bank accounts.

48. The fact that recipients of subsidies must be persons rather than goods is confirmed by the text of Article 2.1 ASCM, which lays down the fundamental requirement of specificity of the subsidy to certain *enterprises*, and by Article 19.3 ASCM, which provides for newcomer (or "new shipper") reviews and focuses on the investigation of the "exporter".[203] The US position is all the more surprising because it runs counter to one of the basic precepts the US claims for itself - that money is fungible. That is the principle that when a company receives an untied subsidy, in whatever form, it must be presumed to affect its entire production and any countervailing duty must be calculated on this basis.

49. USDOC's position in the present case even runs counter to the express provisions of US law. The US countervailing duty statute recognizes that subsidy exists when a financial contribution is provided "to a person" and a benefit is thereby conferred.[204] This same understanding that subsidies are conferred on producers/exporters, not inanimate objects, is found throughout US judicial opinions. Just by way of example, in the *Saarstahl II* opinion quoted approvingly by the United States in paragraph 57 of its First Written Submission and attached thereto as Exhibit USA-19, the US Court of Appeals for the Federal Circuit notes

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[201] *Final Affirmative Countervailing Duty Determination; Certain Hot Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom*, 58 Fed. Reg. 6237, 6240 (27 January 1993). See Exhibit EC-4.

[202] US First Written Submission at, *e.g.*, paras. 100,120, 129, 150, 181, and 183.

[203] According to this provision,

> [a]ny *exporter* whose exports are subject to a definitive countervailing duty but who was not actually *investigated* [. . .] shall be entitled to an expedited review in order that the investigating authorities promptly establish an individual countervailing duty rate for that *exporter*". (emphasis added.)

[204] 19 USC. §1677(5)(B).

that a subsidy is provided to "*producers* of the subject merchandise."[205] Finally, the implications of the USDOC position are inconsistent with other important aspects of US countervailing duty policy. For example, if, after an amortizable subsidy has been received, the company acquires a new productive unit, the production of that unit is countervailable.[206] If the subsidy recipients were assets owned by the company at the time it received the subsidy, no amount of the subsidy benefit could logically be apportioned to an after-acquired productive unit. Thus to the US, either money is fungible or it is glued to assets, depending on whether a privatization transaction is at issue. This is incoherent.

50. This disagreement is not semantic. It is central to the current dispute and to the meaning of the ASCM. In the US view, because "the productive assets which benefited from the subsidy before the change in ownership are the same ones used by the new owners after the change in ownership..., *the successor firm really is no different from the subsidy recipient.*[207] First of all, even under US law, the new, private firm is legally "unrelated" to the former state-owned firm. Even more fundamentally, this approach allows USDOC to ignore that the new, private company has *paid for* the productive assets at issue. Thus, while the European Communities appreciate that the US defence of its practice fails unless it convinces the Panel that untied subsidies are "imbedded" in assets and that a private firm purchased at arm's length for fair market value "is no different from" the state-owned company, the European Communities respectfully submit that these propositions defy logic.

E. The ASCM Does Not Allow for "Irrebuttable Presumptions" That Ignore Whether a Subsidy Exists in the Period of Investigation

51. As argued in their First Written Submission and at the first substantive meeting of the Panel, the European Communities submit that the ASCM prohibits the imposition of countervailing duties on producers under investigation without a determination that this producer is benefiting from a financial contribution. Integral to this understanding of the requirements of the ASCM is the EC's conviction that a Member may not "irrebuttably presume" the existence of a benefit with respect to a company under investigation, and hence the merchandise it produces, simply because an unrelated state-owned firm received a financial contribution prior to that other firm's privatization at arm's length and for fair market value. Simply to assume that a subsidy exists, without determining that a benefit exists, as the US has done, is to contravene the ASCM in the most fundamental manner.

52. Article 19 ASCM provides that countervailing duties may be imposed only where a subsidy has been determined to exist and all requirements for impo-

[205] *Saarstaahl AG v. United States*, 78 F. 3d 1539, 1543 (Fed. Cir. 1996) (emphasis added).
[206] This is the apparent theory behind USDOC's treatment of BS plc as the producer of lead bar after it acquired 100 per cent of UES in 1995.
[207] US First Written Submission at para. 181 (emphasis added).

sition of such duties have been fulfilled.[208] Equally fundamentally, under the express terms of Article 21.1 ASCM, "[a] countervailing duty shall remain in force only as long as and to the extent necessary to counteract subsidization which is causing injury." These provisions preclude a Member from simply ignoring fundamental events subsequent to the initial subsidy bestowal. The European Communities submit that they impose on Members an ongoing obligation to ensure that countervailing duties are imposed only if permitted under the Agreement and, consistent with the object and purpose of countervailing duties, *i.e.*, only to the extent necessary to "offset" subsidization.[209]

53. It should be stated at the outset that the European Communities take no issue with the authority of Members to allocate certain subsidies over a period of time. However, it is obvious that before the allocation may be allowed, a subsidy must be found to *exist*. This means, as a practical matter, that an inquiry into the existence of subsidy may not end with the finding that an unrelated person once received a subsidy that "presumptively" benefits the company at issue. In our view, the ASCM will not countenance a Member making such presumptions "irrebuttably" so as to disregard whether a subsidy has been fully or partially repaid, fully or partially withdrawn, or left behind when a state-owned firm is sold to private owners at arm's length and for fair market value.

54. Nor is this "irrebuttable presumption" saved by the ironic fact that the US employs a "pass through" credit formula (even though it says it is under no obligation to do so).[210] The fact that USDOC applies its own self-derived formula in some instances does not validate the approach taken or otherwise absolve the US of its obligation to conform its countervailing duty practice to ASCM requirements. The European Communities and the Third Parties in this dispute have detailed a number of the more prominent ways in which the USDOC formula distorts reality, and we need not recap those deficiencies here.[211]

55. The most important "irrebuttable presumption" in this dispute is the USDOC view that it is "irrelevant" whether the change of ownership at issue has

[208] In addition to the Article 19.1 requirement that a subsidy exist before countervailing duties may be imposed, Article 19.3 precludes imposition of duties on parties that "have renounced any subsidies" and Article 19.4 limits duties to instances in which subsidies are "found to exist" - not instances in which subsidies are found *to have existed*.

[209] Likewise, the European Communities find no basis for the US claim that the use of the present tense in Article 1 indicates that a benefit determination, once made, need not be examined. There is no textual support for this far-reaching argument. If the drafters had wished to follow a "once-and-for-all" approach, they surely would have used contrasting tenses between the chapeau and the remainder of the text. Instead, the use of the neutral present tense, along with the words "thereby conferred" requires a clear causal link between financial contribution and benefit.

[210] US First Written Submission at para. 148. It should be noted that the US "no obligation" statement is puzzling in light of the earlier DOC reversal of its conclusion that "the sale does nothing to alter the subsidies enjoyed" on the basis that it was "not supported by substantial evidence and not otherwise supported by law". Remand Determination: *Certain Hot Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom* (12 October 1993) at 2.

[211] EC First Written Submission at para. 68 and footnote 62*;* Analysis of Dr. Cooper (see Exhibit EC-13) at pages 3-4*;* and Section I, above.

taken place at arm's length and for fair market value.[212] The US therefore has chosen irrebuttably to ignore the most relevant evidence as to whether the company under investigation - and, by extension, its products - enjoys a subsidy in the real world.

56. It is the view of the European Communities that privatizations such as the sales of UES and BS plc are economic events so fundamental that they must be evaluated - and not presumptively ignored - by investigating authorities of a WTO Member. The core of this position is that, as the result of an arm's-length privatization transaction, the private firm under investigation cannot be said to have received any benefit from a prior financial contribution to a state-owned enterprise. As such, consistent with the provisions of Articles 1, 14, 19, and 21, no "subsidy" exists, and imposition of countervailing duty would constitute penalty, not offset.[213]

57. The European Communities' reading of the ASCM has the added benefit of comporting with economic reality. Once again, as Professor Richard Cooper has written, whether or not the sale of a state-owned company was for fair market value is "the most fundamental" issue that authorities should consider. Irrebuttably presuming that private arm's-length purchasers benefit from pre-privatization subsidies to state-owned firms "states an economic conclusion without having established the residual economic benefit." As Professor Cooper opines:

> The methodology currently utilized by DOC does not comport with sound economic analysis, market valuation principles or standard business practice. As explained above, the key issue in any privatization transaction is whether fair market value was paid for the productive unit purchased; if so, the residual value of any previous subsidy will have been repaid in the purchase price.[214]

58. Once such an impermissible presumption is removed, an investigating authority would be free to perform the ASCM-required examination of whether a subsidy has indeed been conferred on a firm producing, manufacturing, or exporting the merchandise under investigation. In the European Communities' view, any such examination would necessarily find that there is no "benefit" to the private company under investigation purchased at arm's-length for fair market value,

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[212] General Issues Appendix of *Final Affirmative Countervailing Duty Determination; Certain Steel Products from Austria*, 58 Fed. Reg. 37217, 37264 (July 9, 1993). See Exhibit EC-2.

[213] As noted at para. 114 of the EC's First Written Submission, this issue was taken up by the 1994 GATT panel in *United States - Imposition of Countervailing Duties in Certain Lead and Bismuth Carbon Steel Products Originating in France, Germany and the United Kingdom*, which considered that

> the fundamental legal requirement in light of which the consistency of this "pass through" analysis with the Agreement had to be examined was the rule, reflected, *inter alia*, in Article 1, footnote 4, that a determination of the existence of subsidy bestowed on the production of the merchandise was a necessary condition for the imposition of a countervailing duty on the importation of that merchandise.

The European Communities note that the footnote 4 to Article 1, to which that panel was referring corresponds to footnote 36, ASCM. Report of the Panel (1994) (unadopted), para. 420. Exhibit EC-9.

[214] Professor Cooper's Analysis at page 4 (see Exhibit EC-13).

as any benefit from prior financial contributions was enjoyed only by the unrelated former firm. As a result, any countervailing duty imposed would be used not to "offset" advantage, but rather to "punish" an innocent private firm and to "deter" governments from granting subsidies, as explained in the following section.

F. The Object and Purpose of the ASCM is not to "Deter" Subsidization

59. The United States defence of its "pass through" methodology is founded on the view that the "real" object and purpose of the ASCM is "*to deter* and offset trade-distorting government subsidies benefiting merchandise and causing injury to an industry in an importing country".[215] The United States is also of the view that countervailing duty measures specified in Part V of the ASCM are an appropriate vehicle to cure "market distortions." The European Communities submit that the object and purpose of the ASCM in general, and countervailing duties in particular, are different. In our view, a countervailing duty is a "special duty" - a narrowly drawn exception to otherwise applicable free trade rules. Such duties may not be imposed for reasons of deterrence or punishment or to "teach lessons" to trading partners. That the US countervailing duty practice depends on this extreme theory is indicative of the degree to which the US has exceeded the requirements of the ASCM.

60. The European Communities have previously set forth their position regarding the object and purpose of countervailing duties. In the European Communities view, in accord with footnote 36 ASCM and Article VI:3 of GATT 1994, countervailing duties may be imposed only for the purpose of "offsetting" a subsidy. They may be imposed in no other circumstance. In our view, the entire structure of the ASCM indicates that with the exception of the narrow prohibited subsidies category (export and local content subsidies), governments are not prohibited from granting subsidies. Thus, when countervailing duties are imposed for reasons other than to offset a subsidy, they serve to restrict world trade and become themselves a central instrument of market distortion.

61. It is the view of the European Communities, as well as the Third Parties, that there is no ambiguity on these points in the ASCM. Members may apply CVDs to the products of a particular company, during a particular period, after finding the existence of several fundamental prerequisite conditions, including the existence of a benefit and thus a subsidy to a specific enterprise. In contrast, the approach followed by the United States allows for the imposition of countervailing duties as punishment or penalty for "market distortions". The US view is without legal constraint or boundary.

62. The US statements in the present dispute are all the more surprising because they run counter to the express provisions of US law, which provides no

[215] See, *e.g.*, US First Written Submission, at paras. 150, 185 (emphasis added).

basis for the use of countervailing duties in an attempt to create market conditions *ex ante*. As the USDOC's General Issues Appendix provides:

> [I]t does not follow that the statute requires us to somehow 'correct' market distortions which may have occurred due to the provision of subsidies beyond countervailing the benefits received. The CVD law is designed to provide remedial relief as a result of subsidies; it is not intended to recreate the ex ante conditions that existed prior to the bestowal of such subsidies ... The fact that productive capacity may have been created or continues to exist is an irrelevant inquiry beyond the scope of the law".[216]

63. Given the plain meaning of the relevant ASCM provisions, the US attempt to redefine what it means to "countervail" is breathtaking. Yet, the United States offers no meaningful justification for its position. Rather, it attempts to support its view by presenting the Panel with an example of a young man with a rich uncle.[217] The young man constructs a new apartment complex with the rich uncle's funds. In this example, the existence of increased supply makes apartment prices soften and as a result when the nephew sells the building at current market price, he cannot recover cost.

64. How it is that this "rich uncle" hypothetical demonstrates the correctness of the US view of countervailing duties is a matter of speculation. The EC note that the initial contribution of funds came from a private party, not a state treasury. Moreover, the US itself admits that "[w]hether the purchaser of the apartment building received a 'commercially meaningful advantage' as a result of the rich uncle's gift to the nephew is open to conjecture".[218] The US then continues that "the more appropriate consideration is the market distortions caused by that gift." It is remarkable that the US would state that whether benefit passes through to the buyer of the nephew's building is a matter "open to conjecture", for this statement alone would seem to shatter any claim for a presumption of any kind with respect to an alleged pass-through of subsidy from seller to buyer in an arm's-length fair market value transaction. Additionally, there is absolutely no basis in the ASCM for counteracting the market distortions caused by the actions of the "rich uncle" or his nephew. The Agreement is not an antidote for all the world's ills. Moreover, by focusing on market distortion, the United States has managed to confuse an analysis under Article 15 regarding the existence of injury with the appropriate analysis under Article 1 regarding the existence of benefit. There is no basis for such a fusion; these two issues are, and should remain, distinct ASCM analyses.

65. The European Communities believe that the US eagerness to punish the "rich uncle" and his nephew reveals a great deal about the US views towards a company such as British Steel plc. In the US view, British Steel plc must somehow be held responsible for the aid granted to the state-owned BSC, thus enti-

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[216] See GIA at 37264.
[217] US First Written Submission at para. 223.
[218] US First Written Submission at para. 224 (emphasis added).

tling the USDOC to penalize the unrelated, unsubsidized and privately held BS plc as a result.

66. More fundamentally, there is absolutely no indication in the record of the administrative reviews before this Panel that would lend support to such a view as regards BS plc. Most of the subsidy funds provided to the state-owned BSC covered operating losses and payments to retiring workers. The funds did not "create" plants or assets that would not otherwise have existed or that added substantial future value to the enterprise.[219] Rather, the company's capacity was significantly reduced during the period prior to privatization.

67. One final point: the US also argues that countervailing duties should be imposed in certain circumstances to avoid and deter "circumvention".[220] There is no evidence of circumvention in the case before the Panel, and the US alleged no circumvention rationale in the arm's-length fair market value privatization of British Steel. Indeed, circumvention would have been exceedingly difficult, given that British Steel was privatized long before the US articulated its current pass-through methodology. The US view in the first years after the privatization of British Steel was that no subsidies passed through to a company privatized at arm's length for fair market value.[221] Circumvention concerns are, by definition, irrelevant in arm's-length market value transactions.

68. The panel is faced with two very different views on the object and purpose of ASCM and, in turn, the object and purpose of countervailing duties. The European Communities respectfully request that the Panel confirm their view that countervailing duties are meant to offset subsidies and reject the US view that countervailing duties are the appropriate mechanism to "deter and offset trade-distorting government subsidies."

G. The United States Has Significantly Mischaracterized the Meaning and Importance of ASCM Article 27.13 and as a Result Draws Several Unsupported Conclusions From the Provision

69. The United States places substantial emphasis on the text of Article 27.13 ASCM. The US argues that, by implication, this provision, although expressly limited to developing countries, demonstrates that "*all* types of pre-privatization subsidies provided by a developed country Member are allocable to the privatized company's production".[222]

70. The United States submits that this is the "only reasonable conclusion" that may be drawn from Article 27.13. The European Communities will show that the US' arguments are entirely specious. The European Communities submit that a proper reading of Article 27.13 offers no support for the US position.

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[219] As the European Communities have noted repeatedly, any such future value would be properly captured in an arm's-length fair market value transaction.
[220] See, *e.g.*, UK Leaded Bars 1992 Investigation, 58 Fed. Reg. at 6240.
[221] See EC First Written Submission at paras. 5-8.
[222] US First Written Submission at para. 153.

71. It is noteworthy that the US does not attempt to base its argument on *Vienna Convention* principles except to claim vaguely that Article 27:13 "provides context" for interpreting Article 1.1 ASCM.[223] Instead it invokes the principle described in McNair, "*expressio unius es exclusio alterius*" , meaning "to specify the one thing is to exclude the other".[224] The EC will first explore the meaning of Article 27.13 and then discuss its significance as possible "context" for Article 1.1 ASCM before finally dealing with the "*expressio unius es exclusio alterius*" argument.

1. The Wording of Article 27.13

72. As the Appellate Body has made clear, the starting point of a Vienna Convention analysis must be the text of the provision.

> A treaty interpreter must begin with, and focus upon, the text of the particular provision to be interpreted. It is in the words constituting that provision, read in their context, that the object and purpose of the states parties to the treaty must first be sought.[225]

73. Article 27.13 provides that:

> The provisions of Part III shall not apply to direct forgiveness of debts, subsidies to cover social costs, in whatever form, including relinquishment of government revenue and other transfer of liabilities when such subsidies are granted within and directly linked to a privatization programme of a developing country Member, provided that both such programme and the subsidies involved are granted for a limited period and notified to the Committee and that the programme results in eventual privatization of the enterprise concerned.

74. Article 27.13 offers preferred treatment to less developed countries that choose to privatize and thus rationalize state industry. In order to promote such desired behaviour, Article 27.13 allows for special, more lenient treatment under the ASCM of subsidies given by developing countries, whether before or after a privatization, so long as those subsidies are given "within and directly linked to" a privatization programme, that programme is notified to the WTO, and the privatization is, in fact, consummated.

75. The European Communities submit that the proper reading of Article 27.13 is that it shelters developing countries in certain circumstances from otherwise applicable provisions of the ASCM. It offers no support for the US claim that all pre-privatization subsidies in a *developed* nation automatically benefit the new private company under investigation. Article 27.13 applies to subsidies granted "in connection with privatization", not pre-privatization subsidies as

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[223] Para. 155 of the US First Written Submission.

[224] See Lord McNair, *The Law of Treaties* at 400-10 (1961) (Exhibit USA-25).

[225] See Report by the Appellate Body on *United States - Import Prohibition of Certain Shrimp and Shrimp Products* ("US – Shrimp"), WT/DS58/AB/R, adopted 6 November 1998, DSR 1998:VII, 2755, para. 114.

such. There are many ways in which subsidies can be granted to a privatized company apart from them being inherited from the previously state-owned company. In other words, Article 27.13 shelters a new private firm in an LDC from actions under Part III of the ASCM even if the privatization at issue does not occur at arm's length and for fair market value or a subsidy was granted in some other way.

76. The unsoundness of the US view is indeed demonstrated when it argues (at paragraph 153 of the US First Written Submission) that "all types of pre-privatization subsidies provided by a developed country Member, are allocable ... and therefore continue to be actionable".[226] Surely, subsidies have to be actionable and indeed exist *before* they may be allocated.

77. The Panel does not need to be reminded that the United Kingdom is not a developing country, the prior subsidies to the BSC were not granted within or directly linked to that company's privatization, and those subsidies were never notified to the Subsidies Committee. Fundamentally, the provision is an express exception to the otherwise applicable provisions of Part III of the ASCM and is clearly not applicable in the present case.

2. Article 27.13 as Context for Article 1.1

78. To be relevant as context for the purpose of Article 1.1 ASCM in accordance with the *Vienna Convention*, Article 27.13 must shed light on the meaning of the terms used in Article 1.1. It does not. Indeed, Article 27.13 *presupposes* the existence of a subsidy before it becomes relevant.

79. Also, Article 27.13 says nothing about whether benefits "pass through" to purchasers of previously state-owned entities when those entities are privatized at arm's length and for fair market value. Similarly, the provision offers no guidance as to how such "benefits", if any, should be identified or measured.

80. Fundamentally, a provision such as Article 27.13 cannot become "context" for the interpretation of the basic definitions in Article 1.1 simply because it is built on a hypothesis that the conditions of Article 1.1 are satisfied. This can be seen from the absurd results that would occur if the same technique were used for other exceptions in the ASCM. For example, Article 8.2(b) ASCM exempts "assistance to disadvantaged regions" under certain conditions. Just like Article 27.13, this provision assumes that the "assistance" would otherwise be an actionable subsidy. It cannot be used as "context" to argue that if the conditions are not specified then the "assistance to disadvantaged regions" must be considered to satisfy the definition of Article 1.1 ASCM.

3. The Expressio unius es exclusio alterius Principle

81. Latin maxims such as *expressio unius es exclusio alterius* are, as McNair also remarked[227] in the extract from his book supplied by the US in Exhibit US-

[226] See US First Written Submission at para. 153.
[227] Lord McNair, *The Law of Treaties* (1961) at page 400.

25, sometimes valuable servants but must not be allowed to become dangerous masters and must be applied with caution. They often give misleading and conflicting results, especially when used as the US has done in a superficial manner to avoid conducting a proper analysis. It is significant that the rules of the *Vienna Convention* do not refer to them. The purpose of treaty interpretation is, as McNair also remarked[228], to give effect to the intention of the parties to the treaty as expressed in the words used by them in the light of the surrounding circumstances, a principle that one can see clearly reflected in Article 31.1 of the *Vienna Convention*.

82. The maxim *expressio unius es exclusio alterius* can be a guide to the intent of the parties where it may be assumed that the parties, in listing a number of items but not others, deliberately intended to exclude the non-listed items. But what is the "*alterius*" or "other" that the parties to the ASCM are supposed to have excluded in formulating Article 27.13 the way they did? The US suggests that they have excluded the EC view of the meaning of Article 1.1 ASCM that there is only a subsidy where the company under investigation has received a benefit as a result of a financial contribution. But as explained above, Article 27.13 *presupposes* the existence of a subsidy and can only apply once the existence of a subsidy has been established.

83. In reality, the US is simply making an *a contrario* argument and is using *expressio unius es exclusio alterius* as a superficially more plausible synonym. The problem with interpreting Article 27.13 *a contrario* is that there are so many conditions in this provision. Is the opposite of Article 27.13 supposed to prevail when any one of the conditions is reversed? Is the US in effect arguing that since Article 27.13 requires a subsidy to be present, *a contrario* the opposite result applies and Part III (and therefore by necessary implication Part V) ASCM does apply where a subsidy is not present?

84. Why cannot the EC argue that since the negotiators of Article 27.13 ASCM chose to *specify* that this provision applied to Part III of the Agreement this therefore *excludes* any relevance for Part V thereof?

4. Conclusion

85. In conclusion, the European Communities submit that the wording of Article 27.13 does not support the US position, it is not relevant context for the interpretation of Article 1.1 and indeed cannot shed light on the meaning of Article 1.1, and finally, that the US *a contrario* argument based on this provision is misleading and wrong.

H. The US Has Mischaracterized Both the Meaning and Use of the EC State Aid Rules

86. The US contention that the European Communities express a different view of the relevance of a change of ownership in their internal State aid rules to

[228] Lord McNair, *The Law of Treaties* (1961) at page 365.

that which the European Communities argue should be followed with respect to countervailing duties is deserving of brief comment.[229] As the EC demonstrated during the first meeting with the Panel, the US argument is not correct.

87. The *substantive rules* applying to EC State aids are entirely different from those applying to countervailing duty proceedings. Article 87 of the EC Treaty (formerly Article 92) prohibits, subject to certain exceptions, State aid "which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods … insofar as it affects trade between Member States."

88. The *applicable procedure* involves prior notification and approval or disapproval by the EC Commission *before the aid may legally be granted.*[230]

89. The *remedy* against the granting of state aids not allowed by the EC Treaty is *never* the imposition of corrective "offsetting" duties but a *retroactive* declaration of illegality which may entail the reimbursement of the aid. Under the EC rules, consistent with their position before the Panel, countervailing duties can only be imposed on merchandise which *currently* benefits from a subsidy.

90. More fundamentally perhaps, the *object and purpose* of the internal EC State aid rules is to avoid and, if necessary, to address *distortions of competition within the EC* arising from the grant of State aid, at least to the extent that the distortions are contrary to the common interest. The purpose of countervailing duties under the ASCM is quite different, as we have set forth in detail. It is to protect the internal market of another WTO Member by means of an *offsetting* duty at its border. CVDs do not seek to remove any distortion of competition in the country where the producer is located, only to shelter the importing country from the injurious effect of an existing and actionable subsidy.

91. For all these reasons, the EC's policy concerning their own internal State aids has no bearing on the correct interpretation of the countervailing duty rules in the ASCM. The US merely argues that the European Communities have stated that State aid rules may be *relevant* for the EC's countervailing duty regulation.[231] This is misleading. The statement in the EC Commission calculation guidelines to which the US refers was not one of general applicability, but rather, related to a narrow and special case which had nothing to do with privatization or the "pass through" of subsidies. If the EC were to apply US logic[232] and invoke the latin maxim *expressio unius es exclusio alterius*, this would lead to the conclusion that EC State aid rules are not at all relevant in other respects.

92. In any event, what the Commission actually said is that, with regard to equity infusions, it would make an assessment "on a case-by-case basis, taking account of the Commission's practice as regards state-aid policy in this area and

[229] US First Written Submission, at paras. 227 to 233.
[230] See Article 88 EC (formerly Article 93 EC Treaty).
[231] US First Written Submission, at para. 232.
[232] Ibid., at para. 154.

the practice of the Communities' main trading partners."[233] That does not indicate that State aid rules will be followed in countervailing duty cases, even in the special case to which the comment relates.

I. The US "Trading Company" Example is Inapposite

93. The United States has set forth an example involving an unrelated trading company which it claims demonstrates the correctness of the US view that the ASCM does not require "identification of a benefit *continuing* after the original subsidy bestowals".[234] The US presumes that a subsidized producer has sold goods at fair market value to an unrelated trading company that has, in turn, exported those products. The US explains that countervailing duties may be imposed on those products. However, the US then argues that under the position taken by the European Communities in this dispute, such countervailing duties would no longer be permissible, "because the trading company paid the market price for the products it later exported".[235] This view is mistaken.

94. The ASCM, as well as US and EC law, allow for the imposition of countervailing duties on the exports of such a trading company for the simple reason that the manufacture or production of the merchandise currently at issue has benefited from subsidy. This would not change under the ASCM interpretation advocated by the EC in this dispute. The fact that a trading company purchases subsidized products at fair market value has no bearing on the fact that the producer at issue has benefited from subsidy or that its products are countervailable. Thus, the "trading company" analogy used twice by the United States lends no support to the US argument.[236]

J. EC Countervailing Law and Practice Require the Establishment of Benefit During the Period of Investigation.

95. The US has mischaracterized the EC position concerning the treatment of privatization in countervailing duty investigations conducted by the European Commission. As a matter of fact and to put the record straight, the European Communities have not yet come across a countervailing duty case where the issue of privatization was raised. Indeed the US is forced to acknowledge that the European Communities have *never* applied a "pass through" methodology in its own countervailing duty practice.[237] The US merely argues that the European Communities have stated in an internal preparatory document that in some instances subsidies may still benefit the privatized company. This is misleading. The statement in the draft EC Commission calculation guidelines to which the US refers, apart from the fact it was never adopted as such, related to a narrow

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[233] Guidelines for the Calculation of the Amount of Subsidy in Countervailing Duty Investigations, OJ C 394, 17.12.98, at page 10, 11.
[234] US First Written Submission, at para. 131 (emphasis in original).
[235] Ibid., at para. 131 (emphasis in original).
[236] Ibid. at paras. 131 and 198.
[237] Ibid. at para. 227.

and special case concerning subsidies granted in conjunction with the privatization process which had nothing to do with the "pass-through" of previously granted subsidies.

96. Indeed the provisions of the EC's countervailing duty Regulation (Council Regulation 2026/97- Exhibit EC-15) make it clear that the investigating authority *must* in all cases examine the existence of benefit during the period of investigation and cannot simply irrebuttably presume that a benefit conferred some time in the past still continues. In particular, Article 5 of Regulation 2026/97 provides that "*the amount of countervailable subsidies … shall be calculated in terms of benefit to the recipient* ***which is found to exist during the investigation period*** *for subsidization*".[238] Similarly, Article 15.1 of the Regulation permits the imposition of a countervailing duty *"… **unless** the subsidy or subsidies are withdrawn or it has been demonstrated that the subsidies **no longer confer a benefit** on the exporters involved*".[239] Thus, the US argument finds no support in actual EC law or practice.

K. The United States Is Inconsistent in its Expressed View of the Relevance and Effect of An Arm's-Length Fair Market Value Sale

97. In its oral statement, the US cites to the sale of the Richemont power plant in France as evidence that "Commerce's approach can even come up with the result sought by the EC in this dispute, which is to have *none* of the prior subsidies apportioned to the successor company."[240] Leaving aside the fact that the company under investigation was the seller and not the "successor company" as claimed by the United States, closer examination of this sale reveals an important inconsistency in the US practice.

98. The Richemont sale was a spin-off, not a privatization. In fact, according to USDOC, Richemont was sold from one government-owned entity (Usinor Sacilor) to another (Electricité de France). The Federal Register Notice provided by the USDOC draws only a brief conclusion, and does not provide any of the figures used by USDOC in its formula, which deemed that all subsidy remained with Usinor, the company under investigation. The European Communities have requested that the US provide details of the transaction at issue so as to allow the EC to comment fully on this unusual transaction.[241] The limited Notice provided by the US does, however, illustrate a fundamental point.

99. In considering whether Usinor (the seller) received a countervailable subsidy from its 1994 sale of Richemont, USDOC examined whether Usinor "*received more than a reasonable market price from the EDF in this transaction*," by comparison to such factors as the *"independent valuations of the transaction*

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238 Emphasis added.
239 Emphasis added.
240 See US Oral Statement at para. 46 and Exhibit USA-30 (emphasis in original).
241 See EC Request in Response to Question 3 from the Panel.

based on detailed projections of future costs and revenues".[242] USDOC "*found no evidence to indicate that the transaction was anything other than an arms-length transaction for full market value. Accordingly, [USDOC] determine[d] that this programme does not constitute a countervailable subsidy…*".[243]

100. This analysis is remarkable, because it appears to employ for purposes of the Richemont sale, central elements of the benefit analysis proposed by the EC (and rejected by the US) as regards privatizations. In the Richemont sale, of course, USDOC was examining whether benefit was conferred on a *seller* in a transaction with a government entity. The European Communities submit that the considerations of the USDOC are also fully relevant to the possible receipt of benefit by a *buyer* in a transaction with a government entity. Thus, far from supporting the US claim, therefore, this decision amounts to an apparent USDOC admission that (i) no benefit is obtained in a market-based sale; (ii) benefit is properly measured by reference to market benchmarks; and (iii) there is nothing administratively overwhelming about examining the relation between amount paid and what USDOC called the "reasonable market price".[244] The ASCM, in our view, does not allow for such an inconsistency of approach.

IV. CONCLUSION

101. For the foregoing reasons, the European Communities respectfully submit that the US countervailing duty practice as regards privatization fails to conform with the requirements of the Agreement on Subsides and Countervailing Measures, as set forth by the European Communities and the Third Parties in their Submissions and Oral Statements to the Panel.

102. At issue in this dispute are several of the most fundamental precepts of the ASCM. The European Communities are of the view that the United States fails to comply with its obligations under the ASCM by a practice of imposing countervailing duties on the products of private firms that have received no subsidy, solely on the basis of a US irrebuttable presumption that subsidies "pass through" sales at arm's-length for fair market value to these new owners. At the core of this practice is the economically irrational view that whether a company pays fair market value for assets is "irrelevant" to an inquiry as to whether it has received countervailable benefit. In this inquiry, the United States vacillates between the well-settled notion that "money is fungible" and a *sui generis* notion that subsidies are "glued" to assets and somehow "travel" with those assets to their new home. The United States has justified this remarkable practice through a theory of "deterrence" - a limitless concept that would sweep aside the established notion that countervailing duties are "special" duties that may be imposed only to

[242] See pages 30781-82 of the Federal Register Notice supplied in Exhibit USA-30 ("A. Purchase of Power Plant").
[243] See pages 30782 of the Federal Register Notice supplied in Exhibit USA-30 ("A. Purchase of Power Plant").
[244] See pages 30782 of the Federal Register Notice supplied in Exhibit USA-30 ("A. Purchase of Power Plant").

offset subsidy. Finally, the Untied States believes that USDOC practice is not subject to meaningful review by this Panel. The standard of review in this dispute is plain and well settled, and the Panel should not retreat from its obligations to examine, under Article 11 DSU, the conformity of US practice with US obligations to the European Communities under the Agreement on Subsidies and Countervailing Measures.

ATTACHMENT 1.6

ORAL STATEMENT OF THE EUROPEAN COMMUNITIES DURING THE SECOND SUBSTANTIVE MEETING WITH THE PANEL

(Geneva, 14 July 1999)

Introduction

1. Mr. Chairman, Members of the Panel. The Panel has already had the opportunity to hear extensive argument on this case from the European Communities, the United States and the Third Parties. It is not our intention today, you will be pleased to know, to belabour points already discussed at length. Our oral statement will concentrate on a number of key issues. In doing so, the EC will take the opportunity to reply to some of the more egregious assertions by the US in its Second Written Submission.

2. The issues the EC will address are:

- Are Subsidies Given to Producers, Products or Assets?
- Are UES and British Steel plc the same as the British Steel Corporation?
- Article 19.3 Subsidies Agreement
- The Changes of Producer in the Present Case
- Share sales and asset sales
- Whether untied subsidies "attach" to assets
- The US Position on Article 27.13
- Appropriate Standard of Review
- The USDOC Gamma "methodology" is Arbitrary and Irrational
- Areas Where the US has Moved Closer to the EC Position

1. Are Subsidies Given to Producers, Products or Assets?

3. To examine whether a "subsidy" exists according to the terms of Article 1.1 Subsidies Agreement requires, *inter alia,* an examination of what constitutes a "benefit" under the Subsidies Agreement, and who is the recipient of any benefit allegedly "conferred". The EC has argued that a benefit is established by reference to Article 14 market benchmarks and that the recipient of a benefit must be the producer under investigation or review during the relevant period. The US has argued that the benefit must somehow be conferred on assets and that it must follow the assets when an independent company or group purchases ownership control of the assets at arm's-length for fair market value. The European Communities detect understandable doubt on the part of the US with regard to their fundamental premise: that under Articles 1 and 14 Subsidies Agreement they are free to ignore the existence of a benefit at any point after a financial contribution to a state-owned company and under no obligation to find that the private firm under investigation was the recipient of a subsidy. In their Second Written Submission

and the answers to the questions, however, the US now appears to acknowledge that it is benefit to the company under investigation that must be found to exist.[245]

4. In the event there remains any doubt, the EC would make the following brief comments:

- Article 14 Subsidies Agreement, which all parties accept as relevant context, expressly requires subsidies to be measured in terms of the "benefit to the recipient" by reference to market benchmarks;
- The panel report in *Canada -Aircraft*, which the US has also referenced, also defines benefit in terms of advantage to the recipient[246];
- The US found the subsidies granted to the state-owned BSC (which was not the company investigated in the reviews subject to this dispute) to be untied, non-recurring subsidies and in fact measured them in terms of the benefit to the producer which it then allocated across the production. Having done this how can the US now argue that the relevant benefit is that conferred on productive assets? If this were so why did it not measure the benefit to the productive assets?

2. Are UES and British Steel plc the same as the British Steel Corporation?

5. Having established that it is the *benefit to the producer* that is relevant in this case, the next question is: which producer? Here we reach the question of whether countervailing duties may be imposed on the importation of merchandise that is manufactured, produced, or exported by a business enterprise that was *not the recipient* of financial contributions absent a determination that the *current* producer, and hence its merchandise, is benefiting from the financial contributions that may have been received by another party? Under the Subsidies Agreement, it is undoubtedly the existence of a benefit to the current producer during the period of investigation that is relevant to countervailing duty determinations. A benefit must be conferred on the party whose merchandise may be countervailed. Here we come to another essential difference between the EC and the US.

6. The US position is based squarely on the view that the privately owned producer of leaded bars, British Steel plc/UES, is the same as the former state-owned producer, British Steel Corporation. Throughout the US submissions there is remarkable failure to distinguish between these producers where one, the other or both are referred to as "British Steel" and the US sometimes offers express statements that they are the same company.[247]

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[245] Panel Question 3*: Is the US of the view that, when determining the existence of benefits under the SCM Agreement, it is not required to take into consideration events subsequent to the time of bestowal that may offset a subsidy?* The initial US answer, prior to its attempts to quickly qualify the statement, was: *No*. The US then goes on to apparently disavow what it has just stated. See 30 June 1999, US Response to questions from the Panel (US Response to Panel Questions) at para. 22.

[246] See e.g. para. 9.112 of the report.

[247] See, e.g., para. 35 of the US Second Written Submission.

7. By ignoring the private purchase of the assets for fair market value, the US continues to claim wrongly that the EC is asking it to carry out two benefit determinations[248] or to "revisit" a benefit determination[249] or to carry out a new benefit determination on change of ownership or privatization.

8. Mr Chairman, Members of the Panel, the European Communities trust that their position is clear to the Panel:

- First, that a company such as British Steel plc is *fundamentally different* from the former state-owned producer, British Steel Corporation. Not only were the assets purchased at arm's-length for fair market value by private buyers, there is also a difference in the way a private company is required to operate and its relationship to its capital. As Brazil has pointed out, the privatized company has no subsidized capital.[250] We have already discussed this fundamental concept at considerable length.
- Second that the EC is not now and has never asked for "multiple" benefit determinations. It simply requests what the Subsidies Agreement requires - that the US make the correct benefit determination the first time - that the producer under investigation whose products bear a countervailing duty be shown to have actually received a "benefit". It should be noted that in the case before the Panel, BSC is not and *never* was a respondent. Rather, UES and BS plc were subject to investigation, and in each instance the US refused to examine whether UES or BS plc was itself the recipient of a "benefit".

9. Statements such as that in paragraph 7 of the US Second Written Submission that "according to the EC, Article 1.1 *also* addresses specifically how to deal with the situation where the ownership of the subsidy recipient has changed hands" (please note again the US view that subsidies are given to and glued to assets) are simple misrepresentations. The EC has not claimed that Article 1 Subsidies Agreement "specifically addresses" privatization. The EC approach is simply to apply the clear guidance of the Subsidies Agreement to the facts of the case and these require it to be shown that a producer must have received a subsidy in order for its products to be subject to countervailing duties.

10. Mr Chairman, Members of the Panel, let me add one further point before leaving this issue. The US persists in trying to dismiss the EC position by saying that the EC insists on the benefit being attributed to a "legal person". The European Communities have referred to legal persons, just as the US law correctly acknowledges that subsidies are granted to "persons", for the purpose of illustration and explanation. We would stress that we are not suggesting by this that form should prevail over substance. Rather, the European Communities ask for

[248] See, e.g., para. 30 of the US Second Written Submission.
[249] See paras. 9, 119, 128, 135 and 145 of US Second Written Submission.
[250] See Statement of the Government of Brazil at the First Substantive Meeting with the Panel, at page 2.

the producer to be correctly identified. A simple change of legal personality would not in itself require the conclusion that the producer has changed for the purposes of the Subsidies Agreement.

Throughout, the oral statement of the US this morning there are references in quotation marks to an alleged reliance of the EC on the legal personality of the recipient. Most of these are not quotations from any EC statement and the only one for which a source is cited in paragraph 74 of the US oral statement is in fact taken misleadingly out of context. Footnote 24 to the US oral statement refers to paragraph 47 of the EC Second Written Submission where the EC had actually stated:

> "47. The European Communities submit that there is no logical basis for reading these provisions as providing that plants or assets or productive units are themselves the recipients of an untied subsidy. In our view, footnote 36 ASCM and Article VI:3 of the GATT 1994 as properly understood are providing that financial contributions benefit the *act* of production, manufacture, or export. *Financial contributions provide an advantage for economic activities carried on by business enterprises. They are received by legal persons, not inanimate objects.* Steel rolling machines do not have bank accounts." (emphasis added.)

It is clear therefore that the EC was stating that *financial contributions* are received by legal persons, not *subsidies* as the US alleges.

3. Article 19.3 Subsidies Agreement

11. The EC would also draw the attention of the Panel to the fact that the US has expressed a general refusal to consider a private company to be a different producer from the state-owned predecessor in its answer to the EC's question 10 on whether it would conduct a newcomer review under Article 19.3 Subsidies Agreement.[251]

12. In the present case, if British Steel Corporation had been investigated and then privatized after the imposition of the original countervailing duty, British Steel plc could clearly have requested a newcomer review under Article 19.3, since it is unaffiliated to British Steel Corporation and would not have been investigated for reasons other than a failure to cooperate (the reason being that it did not exist at the time of the original investigation). Whether it received a subsidy and the amount would then have had to be individually assessed, as provided for by Article 19.3.

13. The US, in its answer, denies that it would grant newcomer status, but does not explain why. It cannot properly answer this question, of course, because its practice involves continuing to impose countervailing duties, originally assessed on subsidies granted to a producer which no longer produces the subject merchandise, on imports of the subject merchandise from an unrelated producer,

[251] See para. 19 of the US response to EC questions.

without any possibility that the presumption of subsidies passing through to the unaffiliated producer can be rebutted.

4. The Changes of Producer in the Present Case

14. Mr. Chairman, Members of the Panel, let me now come briefly to the concrete facts of this case since they illustrate well the arguments.

15. Two arm's-length fair market value privatization transactions occurred. The first was the sale of the leaded bar production assets of BSC to UES. This occurred two years before the privatization of BSC and *six years before* the initial countervailing duty investigation.

16. In paragraphs 33-35 of its Second Written Submission the US attempts both to shift its approach and to gloss over the importance of the sale to UES by arguing that even if the sale were considered a sale of assets (a fact it acknowledged in its own investigation[252]) *the result would have been that all the subsidies remained with "British Steel"* (the US presumably means British Steel Corporation). The US then suggests that this would make no difference "at the end of the day", as the privately owned, controlled and operated British Steel plc purchased UES 7 years after privatization at arm's-length for fair market value. The US draws its conclusion on the basis that BSC and BS plc are "the same company".

17. Mr Chairman, Members of the Panel it would make a difference. The initial countervailing duty investigation in May 1992 did not concern British Steel plc but only UES, as that company was the only producer and exporter of leaded bars. Despite the statement referenced above, the US assessed a countervailing duty weighted average margin of 12.69 per cent on UES for financial contributions provided to BSC prior to 1985/1986. UES was also the only producer and exporter of leaded bars when the first administrative review in this case was carried out (the 1995 review). As the EC has explained in paragraph 40 of its First Written Submission, the 1995 review was an examination of UES only. In that review, USDOC simply disregarded UES's explanation that it had received neither "financial contributions" of any sort nor any "benefit" from financial contributions paid to BSC. The US assessed countervailing duties, with USDOC simply presuming that UES benefited from subsidies conferred on British Steel Corporation.

18. Mr. Chairman, Members of the Panel the US cannot credibly claim that UES was in reality the same producer as British Steel Corporation.

19. The conclusion is the same for the transfer between British Steel Corporation and British Steel Plc, despite the similarity of the names of these companies. There is no substantive difference between selling one productive unit and selling all productive units.

20. British Steel plc acquired UES during the period covered by the second of the reviews subject to this proceeding - the 1996 review. The private British Steel

[252] See, e.g., EC First Written Submission at para. 30.

plc purchased GKN's interest in UES and integrated it into its business as a wholly owned subsidiary renamed British Steel Engineering Steels Limited.[253] USDOC found, however, that a portion of the subsidies it attributed to UES passed to British Steel plc (glued to the UES assets) and combined them with the "dormant" subsidies USDOC considered to reside in the private British Steel plc. The US then subjected the exports of leaded bars by British Steel Engineering Steels Limited to a higher countervailing duty rate than it applied to UES.

21. The US practice defies even the most basic precepts of fairness to the private producers it investigated. *They paid fully for the purchased assets*. It makes no economic sense to consider that production of leaded bars today is conducted either with the use of subsidized capital or with the use of subsidized assets. The result of the US interpretation of the Subsidies Agreement is that any Member can impose countervailing duties on any producer if some nexus can be shown between that producer and a subsidy recipient. The US can then refuse to justify or support its claim that the producer is benefiting from the subsidies received by the other company by saying "we only have to look at benefit at the time of the financial contribution". This is unsupportable.

5. Share sales and asset sales

22. Mr Chairman and Members of the Panel, this brings me to a further comment on the US Second Written Submission. In paragraph 8(b) the US falsely states that the EC draws some distinction as a result of a decision by investment bankers to privatize a company through a sale of shares rather than via individual sales of productive units or assets. Then, in paragraphs 34 and 35 the US utilizes this mischaracterization of the EC position to argue that some importance attaches to the fact that both the 1988 privatization and the purchase of UES were accomplished through a sale of shares. The US argues that because of these features of the transactions they should have no effect on the pre-privatization subsidies granted to BSC.

23. Mr. Chairman, Members of the Panel let me make quite clear the EC does not consider that form should prevail over substance. We do not argue that structuring a transaction as a share sale rather than an individual sale of each productive unit changes the analysis which is required under the Subsidies Agreement. Bankers may structure transactions in a number of ways, and it is the economic reality that must be examined to determine whether a producer has received a subsidy or not.

24. The BSC privatization was carried out through a series of transactions which involved a creation of a share capital company to which the assets of a state corporation were transferred and then the shares of this share capital company were sold *at arm's-length for fair market value*. These transactions form part of an overall process: privatization. It is the overall process that must be examined, that is the sale of productive assets from a state-owned corporation to a

[253] See, e.g., EC First Written Submission at paras. 34-39.

privately owned share company. Whether this takes the form of an asset sale or a sale of the stock of the company is a matter of form over substance for our purposes; ultimately *what is being sold is the ownership and control of the productive units* and a stock sale is merely one way of achieving that kind of transfer.

6. Whether untied subsidies "attach" to assets

25. The next point which the EC would like to discuss is the contradiction between the principle that untied subsidies paid to a company must be considered as benefiting the whole of that company's production (the "money is fungible principle") and the contradictory notion relied on by the US that benefits from financial contributions "attach" to assets and "travel" with them to the new producer. The US submissions, of course, never explain or justify their initial claim that a subsidy is given to and resides in assets, "travelling" with them wherever they are sold. In fact, the implications of this US position are inconsistent with several other aspects of US CVD policy. If a company that received an untied subsidy closes a productive unit, under US practice *no* portion of the unamortized subsidies "goes to the grave" with that unit. The US continues to apply the full amount of the unamortized subsidies to the remaining enterprise. If, after an untied amortizable subsidy has been received, a company acquires a new productive unit, the US also countervails the production of that unit. If the subsidy recipients were the productive units or assets owned by the company at the time it received the subsidies, how could any amount of the subsidy benefit or be apportioned to an after-acquired productive unit? It could not, but this is exactly what the US does.

26. The US is incapable of explaining this contradiction. In reply to question 9 of the Panel regarding this issue, the US incomprehensibly asserts in paragraph 37 that it

> "rejects the notion that subsidies "attach" to assets or to companies through the operation of any mechanism independent of the SCM Agreement."

The US then quickly takes refuge behind its much-used rationale for failure to address many of the fundamental issues in this dispute, claiming that the Subsidies Agreement is silent on the issue.

27. The European Communities have already explained that untied subsidies may, by definition, be used by a producer to benefit all of its production. This means that when certain production ceases, untied subsidies are deemed to benefit all remaining production of the producer at issue. Another company purchasing the relevant productive assets in an arms-length fair market value sale, would similarly not receive any part of the subsidy, which remains with the seller.

28. The EC would simply note again that it is clear that untied subsidies are not glued to assets sold at arm's-length for fair market value. There simply is no merit to this US claim.

7. The US Position on Article 27.13

29. The next comment the EC would make would be to refer briefly to the arguments made by the US on Article 27.13 of the Subsidies Agreement. The EC can be brief because it has replied in some detail in this issue in its Second Written Submission. The essential error of the US is to interpret Article 27.13 *a contrario* and not relating it in any way to any of the provisions which are relevant for this dispute. The US has not explained how Article 27.13 helps to understand the meaning of any of the terms used in Articles 1, 10 and 19 of the Subsidies Agreement. Simply put, Article 27.13 has no relevance to the dispute before this Panel.

8. Appropriate Standard of Review

30. The US takes three alternative positions in its rebuttal submission and in the answers to the Panel's questions regarding the appropriate standard of review. First, the US briefly argues, at least in response to the Panel questions, that Article 17.6 AD is applicable as a result of the Ministerial Declaration, which stresses the "need for consistent resolution of disputes arising from anti-dumping and countervailing duty measures".

31. Second, recognizing the lack of support it can offer for this position, the US states that if the Panel decides that the AD standard of review is not appropriate in the present case, the *Hormones* Appellate Body ruling applies, *i.e.* that Articles 3.2 and 11 of the DSU apply, but only in certain circumstances.

32. Third, terming the Subsidies Agreement effectively silent on every major issue facing the Panel, the US then suggests these provisions do not apply and, therefore, the standard of review set out in *US - Salmon* and *New Zealand - Electrical Transformers* should be followed, effectively limiting the Panel to assessing whether the approach used by the national authorities was "reasonable".

33. Mr. Chairman, Members of the Panel. While reiterating that the US practice meets no conceivable standard of reasonableness, we would also express our objection to the US' constantly evolving positions on the standard of review. There should be no question but that Articles 3.2 and 11 of the DSU set the standard of review applicable in this dispute.

34. The US argument that Article 17.6 Antidumping Agreement should be determinative, is based on the premise that - and I quote - "the Ministerial Declaration must have some meaning."[254] The meaning which the US proposes to give to the Declaration is that - and I quote again - "a Panel should use the AD Agreement's standard of review when reviewing a countervailing duty proceeding." On top of this already bold interpretation the US adds the even bolder statement that, and I quote for the last time that - "th[e] Ministerial Decision is not relevant in this dispute."[255]

[254] See para. 57 of the US Response to Panel Questions.
[255] See para. 59 of the US Response to Panel Questions.

35. The European Communities take issue with this unfounded interpretation of the Declaration as well as with the fact that the US ignores the Decision. First, a "consistent resolution" of disputes does not allow for an "adoption" of Article 17.6 AD in a different Agreement than for which it was written. The meaning of the Declaration is much more limited, requiring only that parallel provisions in the two Agreements should be dealt with in a consistent way. For example, an allegation that an investigating country had exceeded the maximum 18 months for an investigation should not be treated differently in an anti-dumping and countervailing duty case[256]Taking the far-reaching step of adopting textual provisions into an Agreement which are not there would "add to or diminish the rights and obligations provided in the covered agreements", and would therefore violate Article 3.2 DSU.

36. Second, there is no ground for ignoring the text of the Decision and the US offers none. The text of the Decision is clear, in that it should be decided at a later time whether or not Article 17.6 could be capable of "general application". The European Communities believe that the ordinary meaning of the term "general application" is the "use outside the Anti-Dumping Agreement", or the "use in all other covered agreements of the WTO". The text of the Decision does not contain any preferential treatment for the Subsidies Agreement, which would somehow allow the adoption of the 17.6 standard already at this moment in time in the Subsidies Agreement, and the Ministerial Declaration cannot be considered one.

37. Therefore, the first step in the US argumentation on the appropriate standard of review is unfounded. As stated earlier, the European Communities believe the second step conceded by the US is in fact the only appropriate standard of review. It is based on Article 11 DSU and supported by Article 3.2 DSU. This standard should be applied with regard to all covered Agreements (except of course the AD Agreement), for both factual and legal questions.

38. Then, the US introduces its third step, arguing, although at this stage somewhat tepidly, that the relevant agreement is "silent" on the key issues in dispute. As stated already numerous times by the EC, the Subsidies Agreement is *not* "silent" on the fundamental obligation of a Member to establish the existence of a "benefit", and therefore a "subsidy" which may be "offset" by countervailing duties, to the company under investigation. This determination of this fundamental Subsidies Agreement requirement cannot be equated, as the US has done, with methodological issues such as how to calculate adjustments for inflation or the cost of production of custom-made goods. Finally, there is no room for a reliance on the two pre-WTO cases, for reasons set out in the EC's Second Written Submission[257].

39. In conclusion, the only applicable standard of review in this case is found in Article 11 DSU.

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[256] Thus, for example, disputes regarding Articles 5.10 AD Agreement and 11.11 Subsidies Agreement should be resolved in a consistent way.

[257] See paras. 25 and 26.

9. The USDOC Gamma "methodology" is Arbitrary and Irrational

40. The US obviously feels ill at ease defending its "gamma methodology". It even argues that the EC has not challenged the methodology as being unreasonable.[258]

41. Mr. Chairman, Members of the Panel, while the EC would note that it did term the methodology "unreasonable" at paragraph 127 of its First Written Submission, we would also note that the EC was far more damning in its analysis. The European Communities stated that the methodology was irrational, absurd and produced wholly arbitrary results.[259] The EC and others have also repeatedly set forth why this is the case.

42. The Panel has also sought to elicit a rational explanation of the methodology with its questions 6 and 7. The US has, not surprisingly, been unable to produce one in its responses. This inability results from the serious flaws in the USDOC's self-derived creation. Even if a company is sold at fair-market value, a low "gamma" (in itself a meaningless number) may result in a substantial amount of subsidies "passing through" to the buyer, despite the complete absence of any benefit. This is because no matter the price paid, the proportion of repayment remains constant. The approach defies logic.

43. As the European Communities have stated a number of times, even the most cursory examination evidences that the USDOC "methodology" is both arbitrary and irrational. A simple example utilizing the facts of the present dispute amply illustrates the point. USDOC has conceded on the record that UES and BSC were privatized at arm's-length for fair market value. Demonstrably, no benefit is conferred on the private company in this situation. In the absurd case, however, that the buyers of BSC had agreed to (1) first purchase the assets at their full fair market value (£2,500 million), and then, (2) pay the UK Government (as a penalty) the full balance of the pre-privatization financial contributions to BSC that USDOC maintained were somehow outstanding (approximately £3,400 million, despite the complete absence of any benefit to the private company), the total cost to the buyers would have been approximately £5,900 million. Yet, "repayment" of the same pre-privatization financial contributions under the USDOC's gamma-based privatization methodology would have required a sale price of approximately £7,560 million - nearly 30 per cent more than the arm's-length fair market value of the assets *plus* an additional penalty payment of *all* pre-privatization subsidies to the state-owned BSC. On its face, such an outcome cannot be sustained.

44. If the Panel needed any further demonstration of the arbitrary nature of the methodology, the US has provided it in answer to the Panel's question n° 10. In paragraph 39 of its response, the US attempts to explain how it would be possible for all subsidies to be allocated to the selling company under its methodology.

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[258] See para. 72 of the US Second Written Submission.
[259] See, e.g., paras. 68 to 70 of the EC First Written Submission.

45. Incredibly, the US first refuses to provide the Panel details of the Richemont transaction, despite having offered this specific *government-to-government spin-off* to the Panel and EC as the US' prototypical example justifying the reasonableness and rationality of its *privatization* methodology. Now dropping Richemont, the US instead proposes a new "hypothetical scenario" to the Panel, carefully offering no assurances that the new hypothetical bears any resemblance to the facts of the Richemont sale. It uses an example of a company worth £1 million pounds which has received nonrecurring subsidies of £250,000. It then asks the Panel to assume that the ratio of nonrecurring subsidies to net worth is one quarter or 25 per cent. This is a very convenient assumption since this results in precisely £ 250,000 being allocated to the seller.

46. All that this new hypothetical establishes is that one-quarter of a million is 250,000. Fundamentally the reason the US example is misleading is that in the situation described, the US methodology would not ever give rise to a gamma of one quarter. Rather, the US would look at a number of years corresponding to the useful life of assets, for example 18 years. If the 250,000 pounds had been received in one year and no subsidies would have been received in the other 17 years the US would then take a simple average of one quarter and 17 zeros and come up with a gamma of about 1 per cent! Similarly, if £250,000 pounds had been spread over the AUL period, the ratio of subsidies received in any year to net worth in any year would *mutatis mutandis*, also be well below 25 per cent. Footnote 17 of the EC First Submission highlights this serious flaw in the USDOC's use of its self-created gamma.

47. Let us return to the Richemont example briefly, for the US had claimed that it shows that USDOC sometimes does not apportion prior subsidies to a successor company.[260] The US neglects to note that Richemont was not a successor company and was not even the company under investigation. It fails to note that the Richemont sale was not a priva*tization*, but rather a sale *to a government*, and the US approach had the effect of the highest possible countervailing duties being imposed on the company (Usinor) that was under investigation.

48. The Richemont example provided by the US does, however, illustrate one further point. As the EC explained in paragraphs 99 and 100 of its Second Written Submission, USDOC did examine in that case whether the sale was conducted at arm's-length for fair market value in order to determine whether the sale resulted in an additional subsidy being provided to the seller (which was the company under investigation). This demonstrates that it is perfectly feasible for an investigating authority to examine whether a sale occurs at arm's-length for fair market value and to consider, using market benchmarks that any difference between the price paid and the fair market value price could constitute a subsidy. Richemont, in our view, simply demonstrates that the emperor indeed has no clothes.

[260] US First Oral Statement at para. 46 and Exhibit USA-30.

10. Areas Where the US has Moved Closer to the EC Position

49. Although very clear differences continue to separate the US and EC positions in this dispute, we feel that it is important to conclude by noting two areas in which the Parties apparently do now agree.

Financial Contributions/Benefit

50. The EC believes that there has been an important revision in the US view regarding the Article 1 "benefit" requirement. (There never has been much of a practical difference between the parties on the issue of "financial contribution". All parties apparently agree that no financial contribution has ever been provided to BS plc and that financial contributions were made in the 1980s to BSC.)

51. On the issue of benefit, the EC had understood that the Parties differed substantially, in that the US seemed to deny that a benefit must be determined to exist during the period of investigation or review. We had understood that the US believed that "benefit" could simply be irrebuttably presumed to continue throughout an allocation period fixed by reference to US domestic tax tables, regardless of any and all subsequent events, including the sale of assets or a productive unit to an independent enterprise for fair market value. We note that this view is apparently no longer held by the United States, which has plainly stated in Response to Panel Questions at paragraphs 12 and 15.

> The United States is also of the view that authorities must determine whether there is a benefit in the POR ...
>
> Clearly, the legal requirements of Article 1, including financial contribution, benefit, and specificity, must be met in each POR.[261]

52. This is, of course, the EC position as well. In the face of these US statements, it must be noted, however, that the US never made any such determinations with respect to British Steel plc during any of the administrative reviews before the Panel, but rather simply assumed the existence of such benefit due to financial contributions given the British Steel Corporation.[262]

[261] Similarly, the US has expressly recognized that the use of an allocation methodology is permissible only where a benefit exits during each of the years within the relevant AUL. US Rebuttal Submission at para. 22: ("the subsidy 'benefit' ... continues over time, and therefore may be amortized over time"); US Response to Panel Questions at para. 10 (in the case of a subsidy to the widget industry with an AUL of 10 years, "the United States considers that it is appropriate for authorities to find that a financial contribution and a benefit exist in each of those 10 years").

[262] We further emphasize that the US has continued to mischaracterize the EC "benefit" position as requiring a "continuation of the economic effects of a subsidy", as set forth in the US Response to Panel at para. 12. The European Communities have never argued that.

Market distortions

53. In US Response to Question 13 from the Panel, the United States backs away, at least on occasion, from its claim that the purpose of countervailing duties is to cure market distortion and deter subsidy. For example, at paragraph 46, the US states that "The SCM Agreement permits countervailing duties to offset subsidies, not the amount of economic distortion caused by subsidies." That statement, with which the European Communities fully agrees, seems a long way from the US example of the "Rich Uncle", but we appreciate it nonetheless.[263]

54. We note, however, that the US does not seem to be able to discard its prior theory altogether. By way of example, we would point the Panel to US statements in the very next paragraphs that arm's-length market value privatizations do not "automatically eliminat[e] whatever *economic distortions* remain from pre-privat*ization* subsidies" (paragraph 48) and that investigation of a private firm, as opposed to the state-owned subsidy recipient is "inadequate because it does not address the *trade distortions* which subsidies cause..." (paragraph 52).

Conclusion

55. Mr. Chairman, Members of the Panel, this case raises some fundamental and important issues:

- May countervailing duties be imposed without violating the Subsidies Agreement on the imports of the goods of a producer absent a determination that the producer and thus his merchandise is benefiting from a financial contribution? May a Member instead irrebuttably presume such benefit irrespective of intervening events? *The answer is clearly no*.
- Under the Subsides Agreement, does a business enterprise (UES) that acquired productive assets, *at arm's-length for fair market value,* from a subsidy recipient (British Steel Corporation) benefit in comparison to Article 14 market benchmarks from the subsidies previously received by the seller? In the same light, is there a basis for treating the arm's-length fair market value privatization of all a state-owned company's (British Steel Corporation's) assets differently from the fair market value sale of one or more productive units to another business enterprise? *The answer is clearly no*.

56. Mr. Chairman, Members of the Panel the EC has sought in the remarks it has just presented to avoid repeating arguments that it has already made in its Written Submissions while still responding to the new arguments put forward by the US in its Second Written Submission and in its Answers to the Questions. We hope that we have succeeded but if there are any issues which the Panel considers that the position of the EC is not entirely clear or if there are any points made by

[263] US First Written Submission at para. 223; EC Second Written Submission at paras. 64-68.

the US which the Panel considers the EC has not answered, we will be very happy to do so in reply to questions. Thank you for your kind attention.

Concluding Remarks of the European Communities

57. Mr Chairman, Members of the Panel, the EC would first of all like to thank you for the effort you have put into this case and the discussion we have had over the last two days.

58. The EC would like to underline at this stage the following points arising out of our discussion:

1. Article 1.1 - Existence of a Benefit

59. The US has stated in paragraph 7 of its oral statement this morning that the USDOC "has determined a benefit in each of the reviews". However, the US explains that what this really means is that it has deduced the existence of a benefit from the "allocated benefit stream" which it has calculated on the basis of past circumstances. Thus in reality the US is not examining whether there is a benefit in a period of review and is not taking into account changed circumstances. In fact it only takes into account changed circumstances when a subsidy is repaid.

60. The US justifies this by saying that it cannot look at the effects of subsidies (because of its internal law). In fact it is refusing to examine the *existence* of the subsidy.

61. The related question which we have discussed at some length today is of course on whom or on what the benefit required to create a subsidy must be conferred. The EC has explained that at least in the case of the capital infusions involved in the present case the only basis of examination can be the producer. When was it ever established that UES or British Steel plc were ever "unequity-worthy" or un-creditworthy?

2. Fungibility vs Pass Through

62. The discussion we have had shows even more clearly than ever the irreconcilable conflict that exists between the "money is fungible" principle applied to large untied subsidies such as capital injections and the approach taken by the US to the "pass through" of subsidies. Basically untied subsidies cannot attach to assets or "travel with them" to the new owner. This is a matter of definition.

3. The Application of the pass through methodology to private companies

63. The fallacy of the US methodology and the fact it is really *only* meant to address *distortions* of *trade* in the absence of any benefit to a purchaser who has paid fair market value for the assets is simply demonstrated by the fact the same methodology is applied in transactions between private parties (e.g. the UES purchase by British Steel plc). In a transaction between private parties there is no reason to assume that both the seller and the purchaser have not tried to maxi-

mize benefits under the transaction so there can be no passing of benefit from previous subsidies to the purchaser (as this would mean that the seller did not properly defend his interests and would have granted something to the purchaser for free. In the real world, of course, this does not occur. To argue that somehow the sold assets (e.g. by GKN) were offered to the buyer with a hidden bonus (the presumed "benefit") only demonstrates the irrationality of the US benefit stream irrebutable presumption and its incompatibility with the Subsides Agreement.

4. The "Assets are the Same" argument

64. In answer to the objection that UES and British Steel Plc were not the same as British Steel Corporation, the US has often stated that the productive assets are the same. For example at paragraph 78 of its statement to this meeting the US said:

> "it was appropriate to countervail imports from the successor company because it was continuing to use the very same productive assets as the predecessor company, i.e., the company that originally received the subsidy."

65. Mr Chairman, Members of the Panel, this cannot be the right test for many reasons as we have explained. The EC would only add that assets are also the same before and after a subsidy is repaid but does this mean that there is no change to the "allocated benefit stream"? Indeed in the case of British Steel Corporation, the assets were the same before and after payment of the subsidies. They were paid in large part to shut down productive capacity, no to create it.

5. Cases in which the US would re-examine benefit

66. We have witnessed a certain amount of attempted backtracking by the US today when it has stated that it would not necessarily apply its pass through principle if it were really shown that a producer were different or if the assets of a liquidated company were shipped of elsewhere and reconstructed.

67. The only comment that the EC need make is that USDOC refused to consider the argument that UES and British Steel Plc were different from the British Steel Corporation in the present case. The EC refers the Panel to the uncontested description of the situation in paragraphs 34 to 49 of the EC's First Written Submission and the clear statements in paragraph 87 of the US First Written Submission.

6. "Hopeless Morass" Argument

68. The US has also argued that determining whether the producer is the same or different "as a practical matter, the EC's approach would seem to involve the investigating authority in a hopeless morass."

69. The EC's response is that the whole purpose of countervailing duty investigations is to clarify sometimes-complex factual situations and the US often does so. It established that UES was independent of British Steel Corporation.

On the related question of whether it would be difficult to establish whether a sale was at fair market value and at arm's length, the EC would point out that the US did this in the Richemont case which it has invoked.

7. Standard of Review

70. We have not directly discussed the standard of review but the US has repeatedly relied on the argument that the Subsidies Agreement is silent on all the key issues and that therefore it does not restrict the US from adopting the rules it chooses. The EC has often said that this is not the correct approach and that the Agreement is not silent on the issues of concern to us. All the rules and principles on which the EC relies to establish its position are contained in the Agreement. Of course the Agreement does not specifically address change of ownership but that situation is nonetheless regulated by the rules and principles that it does contain.

71. The other comment the EC would make is that Article 32.1 of the Subsidies Agreement specifically provides that all action under the agreement shall comply with its provisions and Article VI GATT 1994.

8. Mr Hufbauer

72. A lot could be said about the opinion of Mr Hufbauer but the EC will limit itself to pointing out that he seems to have been misinformed about the factual situation when he says:

> "[O]nce a nation abandons socialism, its exports are free from US countervailing duties unless the government slips back into subverting market mechanisms with new subsidies - a temptation countervailing duties are intended to deter."

73. British Steel Plc is not an instrument of socialism and it has not been determined to have received any subsidies, let alone "new subsidies".

74. Finally the EC would only refer the Panel and the US to the opinion of another celebrated US economist, Mr Greenspan who has made pertinent comments on the use of protectionist legislation in a recent speech which the EC attaches with the permission of the Panel as Exhibit EC-14.

Mr Chairman, Members of the Panel thank you for your attention.

ATTACHMENT 1.7

RESPONSES OF THE EUROPEAN COMMUNITIES TO WRITTEN QUESTIONS FROM THE PANEL DURING THE SECOND SUBSTANTIVE MEETING WITH THE PANEL

(Geneva, 30 July 1999)

Introduction

1. In Section A below the EC answers the questions put to it by the Panel at the Second Meeting. In Section B the EC responds to the invitation of the Panel to comment on the issues raised in some of the Panel's questions to the US.

Section A - EC answers to questions from the Panel

Q.1. What is your understanding of the requirement found in Article VI:3 of GATT 1994, whereby: "No countervailing duty shall be levied on *any product* of the territory of any contracting party … in excess of an amount equal to the estimated bounty or subsidy determined to have been granted, directly or indirectly, on the *manufacture, production,* or export of *such product* in the country of origin ...". (Emphasis added). Does this provision, in the opinion of the [European Communities], require the investigating authorities of the parties to determine that a subsidy has been granted on the manufacture or production of the specific product on which a CV duty is imposed?

Would it be permissible, under this provision, to base the imposition of such a duty on a determination of subsidization that has been granted seven-ten years earlier and/or to a different company, and/or on a production of different products taking place under different circumstances? Should this provision be understood as to require the investigating authority to determine that such a past subsidy is at least benefitting present production?

2. Yes. The EC considers that Article VI:3 requires that it is always necessary to establish the existence of a benefit and therefore a subsidy on the manufacture, production or export of the specific product on which a countervailing duty is imposed. The reference in Article VI:3 to the "manufacture, production, and export" in no way supports the US position. This reference clearly limits the application of countervailing duties to no more than the subsidy found to benefit the manufacture of a product. This limitation does not undermine the observation that a company must *receive* a subsidy before it could possibly be applied to benefit the manufacture of a product. The finding that a benefit is granted to a recipient (pursuant to Article 1) is a condition precedent to a finding that a subsidy then benefited the manufacture, production or export of merchandise. The granting and receipt is required as a threshold matter to the application of countervailing duties.

3. Countervailing duties may be imposed on a product as a result of subsidies made years earlier where it is established on the basis of positive evidence that the payments constitute a lasting financial contribution and provide a continuing existent benefit to the company over a period of years. This can be the case with capital injections. In such cases, where the financial contribution is not tied to any particular product (as will normally be the case with capital injections), all the company's production can be considered to be subsidized, including products that were not manufactured at the time of the injection or were not manufactured under the same circumstances (e.g. with different machinery).

4. Where, however, there has been a privatization at arm's-length for fair market value and the current producer of the product is not the same as the one which received the subsidy, there will not normally be any basis for considering the privatized company's products subsidized. A basis to consider a benefit to exist occurs only in the event the criteria set forth in the ASCM and the European Communities prior submissions to the Panel are not satisfied, *i.e.* that an advantage has been conferred by reference to market benchmarks. This might occur in a transaction that is not made at fair market value or when there has been no substantive change of producer (for example where the new producer is controlled by the same interests as the former). There is accordingly *no* basis for considering the products of the new producer subsidized where it has merely purchased assets from the former producer at arm's-length and for fair market value.

5. In other words, a countervailing duty may only be imposed where the investigating authority determines that the past subsidy to a state-owned entity is benefiting the present production of the private party under investigation or review. Such benefit must be established on the basis of positive evidence. Evidence may not be ignored and the existence of a benefit may *not* be simply assumed as the result of an "allocated benefit stream ", which is itself based on a benefit found to have existed only in the past for a state-owned entity. There is no basis for such an irrebuttable presumption.

Q.2. In the EC's 2nd submission you keep emphasizing that the fact that the subsidies have been granted in the past to another unrelated producer - not the producer under investigation - is irrelevant. How would the EC relate to a situation where a previously subsidized company is privatized through the sale of its shares to a private new owner - in an arms-length fair market value transaction? Would you consider that as always and necessarily extinguishing all past subsidies? If so why? Has the company under investigation in fact received a subsidy?

6. The EC's position is that the correct focus of an investigation is the current producer of the allegedly subsidized goods on which *offsetting* countervailing duties may potentially be imposed. The question raised, therefore, is whether the current producer obtains a benefit from financial contributions made to other producers including to the previously state-owned company. The EC has explained that a company privatized at arm's-length for fair market value is fundamentally and necessarily different from the previous state-owned producer. It is in particular not subject to the same control and does not operate with subsidized capital or subsidized assets, having purchased them in an arm's length fair market

value transaction. *It has paid fully and completely for everything it has received.* Therefore, it has received no benefit by reference to market benchmarks as the result of a prior financial contribution made to a state-owned company. The private company under investigation has not received a subsidy in this situation.

Q.3. How would the EC relate to the case, mentioned by the US, where a non-recurring subsidy was specifically granted in order to purchase machinery, and after three years the machinery became obsolete because of technological advance? Since you have stated in your responses to the questions of the US (p. 2) that "the investigating authorities *must in all cases* establish the existence of a benefit to the producer under investigation *during* the period of investigation or period of review", wouldn't that mean that if you were conducting a new review in the case mentioned above, that you would have to conclude that there is no longer any benefit to the company in question?

7. If the subsidy were provided to the company subject to a requirement that it purchase the specific machinery it would constitute a tied financial contribution which would no longer confer a benefit once it had become obsolete (in the sense that it can no longer be used to produce the goods in question). If, however, the company were to resell the machinery to a party which wanted to use it, then the subsidy originally provided to purchase the machinery could provide a benefit to the company after the machinery had become obsolete up to the amount of the sales price.

Q.4. In its written reply to written question 11 from the panel, the US asserts that the EC contemplates two benefit determinations (i.e., at the time of subsidy bestowal and at the time of change-in-ownership) to be made during the original investigation. The US argues that the EC would not revisit these determinations in any subsequent review. Please comment on the US understanding of the EC position.

8. The EC position is that there is no need to "revisit" a determination for the state-owned BSC - simply a need to conduct a proper examination and determination of the *existence* of benefit and subsidy for the relevant private producer concerned in each investigation, respectively, UES and British Steel plc.

9. As regards its own practice, the EC has explained that its legislation clearly *requires* it to establish that a benefit exists. Article 5 of Regulation 2026/97 provides that "the amount of countervailable subsidies … shall be calculated in terms of benefit to the recipient **which is found to exist during the investigation period** for subsidization".[264] Similarly, Article 15.1 of the Regulation permits the imposition of a countervailing duty "… **unless** the subsidy or subsidies are withdrawn or it has been demonstrated that the subsidies **no longer confer a benefit** on the exporters involved".[265]

[264] Emphasis added.
[265] Emphasis added.

Q.5. Please respond to the three questions set forth in para. 27 of the US second written submission.

10. The US questions were:

> "27. Indeed, any number of scenarios can be imagined where a change in ownership is not accomplished through a straight sale of shares or a straight sale of assets, and the corporate laws of various Member countries come up with different answers as to whether the company is the same or different. Is the EC arguing that Article 1.1 *requires* the investigating authority to make a general distinction between a sale of shares and a sale of assets, but leaves it to the discretion of the investigating authority to determine the significance of more complicated transactions? Or, is the EC arguing that Article 1.1 even explains how the investigating authority is to handle the more complicated transactions? And, whichever position the EC takes, where can any of it be found in the SCM Agreement? Plainly, the EC is going far beyond the terms of the SCM Agreement when it begins distinguishing between a sale of shares and a sale of assets."

11. The general answer to the first two questions is in each case no, as the EC trusts it has made amply clear in its submissions. The EC has not argued for a general distinction between privatizations accomplished through arm's-length fair market value asset sales or the same privatization transaction accomplished through an arm's-length fair market value share sale. The EC has also not argued that Article 1.1 provides specific detailed instructions on "more complicated transactions". Article 1.1 sets forth, *inter alia*, that for a subsidy to exist, a benefit must exist.

12. As regards the third question, the EC's position may be found throughout the ASCM, as it has set forth in its previous submissions. The EC recognizes that the ASCM does not specifically lay down detailed rules for changes of ownership, just as it does not lay down detailed rules for many other important factual circumstances. In all such cases it is simply necessary to apply the clear rules and principles provided in the Agreement.

Q.6. At para. 53 of its second written submission, the EC "take[s] no issue with the authority of Members to allocate certain subsidies over a period of time." Furthermore, in response to written question 1 from the US, the EC accepts that if "a non-recurring financial contribution was made in 1985, and the POR is 1990, the investigating authority could assume that the financial contribution confers a continuing benefit on the company under investigation in 1990 …"

Is the fact that an authority is entitled to allocate non-recurring subsidies over time based on the assumption that both the financial contribution and the resultant benefit continue over time? If not, what is the basis for such allocation? If so, what is the basis for the assumption that both the financial contribution and the resultant benefit continue over time? Isn't the assumption based on an understanding that both the financial contribution and

benefit are embodied in a company's productive assets, and therefore benefit the company's production over the useful life of those assets?

13. As the EC explained, notably at paragraph 55 of its First Written Submission, a financial contribution constitutes a subsidy when it benefits a producer by conferring an economic advantage that it would not otherwise have enjoyed. This economic advantage or benefit may be enjoyed or consumed immediately or may persist for a number of years. It is the latter hypothesis that is relevant in the present case.

14. A financial contribution that confers a lasting benefit can also be considered as being made over a correspondingly extended period of time. Although the *payment* (of a loan or an equity infusion) is normally effected at a single point in time it is in economic terms a continuous stream of financial contribution equal to the difference between the remuneration of the loan or equity infusion and the market rate. In this way one can consider the financial advantage as existing throughout the relevant period in the same way as the benefit.

15. Where the subsidy consists in the government making available a piece of machinery for a specific purpose, the subsidy may benefit the company throughout the useful life of that machinery. However, in the case of *capital injections* untied to any assets, the subsidies (financial contribution *and* benefit) can only be considered embodied in the capital of the company rather than the assets. That is why they can not pass through to a subsequent arm's length purchaser of the assets for fair market value.

16. Coming back to the facts of the present case, this explains why the capital injections provided to the state-owned British Steel Corporation demonstrably provided *no* benefit to UES and British Steel Plc under investigation by USDOC.

Q.7. Are there circumstances in which a producer's production may "benefit" from a "financial contribution", without the producer itself "benefiting" from a "financial contribution"? Please explain, and provide examples if relevant.

17. The EC is not currently aware of such circumstances.

18. Of course, a financial contribution may sometimes be provided to a different person than the person obtaining the benefit, but if the production benefits then so must the producer.

Q.8. Smith Ltd., a producer of widgets, is wholly owned by Mr. Smith. The government commits itself to pay Mr. Smith (not Smith Ltd.) $0.02 for every widget sold by Smith Ltd., provided Smith Ltd. cuts its widget resale price by $0.01. Does the $0.02 per unit payment to Mr. Smith constitute a subsidy on production by Smith Ltd.? Please explain.

19. Yes. As the sole owner of Smith Ltd., Mr Smith controls Smith Ltd. The situation described is somewhat analogous to a payment made to a holding company rather than directly to the producing company. Also, the example describes a tied recurring subsidy directly linked to the sale of widgets.

20. In discussing the relevance of this question for the case at hand there was discussion with the Panel of the case of upstream subsidies. Here the clear rule is that which was established in *Pork from Canada*.[266] An upstream subsidy, for example to the production of pigs which are not exported, cannot be considered to be a subsidy to the downstream product (which is exported). It is necessary to establish a separate benefit to the downstream product in the form of lower input prices. The amount of the benefit is then the reduction in the price that the downstream producer has to pay for the input. The same approach applied to privatization would require it to be shown that the subsidy to the original producer caused the new producer to be able to obtain the assets at a price lower than would have otherwise been the case in comparison to market benchmarks. The US, of course, has made no such demonstration or even attempted to demonstrate this is the case in the present dispute. It has not done so because the US itself has conceded that the privatizations occurred at arm's-length for fair market value. Instead, it terms this central established fact "irrelevant" to privatizations despite its own upstream subsidy practice.

Q.9. In response to written question 12(d) from the US, the EC asserts that "[w]hether the new producer / exporter which has purchased the assets has obtained a benefit depends, of course, on the terms of the transaction (fair market value, arm's length transaction)." Does this suggest that a "financial contribution" potentially conferring a "benefit" passes through in a change-in-ownership transaction? If not, what could be the relevant "financial contribution" for the purpose of imposing countervailing duties on imported goods produced by the privatized company. Please explain how the terms of the change-in-ownership transaction demonstrate whether or not the relevant "financial contribution" has conferred a "benefit" on the new producer/exporter which has purchased the assets?

21. As the EC has set forth in prior submissions, a financial contribution and benefit may be conferred in circumstances where the transaction was not for fair market value. In such circumstances, consistent with Article 14 ASCM, the financial contribution and benefit would be the difference between the price paid and the market value of the assets (as the EC explained in paragraphs 59 to 61 of its First Written Submission). The arm's-length fair market value analysis set forth in the Richemont case provides one example of how such a possible subsidy can be investigated and established.

22. In the case of UES/British Steel Plc, USDOC found as facts in each case that the assets were acquired in arm's-length transactions for fair market value (see paragraphs 30, 31, 36 and 45 of the EC's First Written Submission).

Q.10. The EC claims that, in the three administrative reviews at issue, USDOC should have determined whether "financial contributions" con-

[266] *United States - Countervailing Duties on Fresh, Chilled and Frozen Pork from Canada*: Report of the Panel, DS7/R-BISD 38S/30 (11 July 1991). See paras. 4.6 and 4.9 of the report and discussion in EC's First Written Submission at para. 114 *et seq.*

ferred any "benefit" on UES or BSPLC. What, according to the EC, are the relevant "financial contributions" that should be demonstrated to have conferred the "benefit".

23. As explained in answer to the previous question, it would have been necessary to determine that the sales was not at arm's-length and for fair market value and to calculate the undervalue. That would have been the "financial contribution".

Q.11. What does the EC mean by the terms "productive assets" and "productive unit"?

24. The EC believes that it has used the terms "productive unit" and "productive assets" in the same way as the US - indeed it has used these terms principally to describe the contested "pass through " philosophy of the US. The EC understands that the US uses the term "productive unit" to denote productive assets sold as a going concern, that is notably with its goodwill. The EC considers goodwill (or whatever additional element is included in the sale) to be an asset like any other and does not see how the inclusion of goodwill can change the analysis and justify the adoption of the US "pass through" approach. The US seems to accept this since it explained during the discussion at the Second Meeting with the Panel that the only reason it did not apply its "pass through" philosophy to mere asset sales was the administrative difficulty of following every single asset (e.g. a typewriter).

Q.12. Were BSC's Special Steels Business assets acquired by UES, or by the owners of UES? Were the terms of the transaction negotiated by UES, or by the owners of UES? Did the owners of UES pay any price for the BSC assets acquired by UES?

25. The assets of BSC's Special Steel Business were acquired by UES and USDOC treated that acquisition for purposes of its countervailing duty analysis as a purchase of the assets by UES. See EC First Written Submission at paragraph 30, and Exhibit EC-4. Because USDOC found that UES was an entity independent of BSC and not controlled by it, USDOC treated the transaction as one in which one company acquired a productive unit from an unaffiliated seller.

26. UES was not in existence at the time that BSC and GKN negotiated the terms for establishing their joint venture (which became UES). In those negotiations, which USDOC found to have been conducted at arm's-length and on a commercial basis (see 58 Fed. Reg. at 6240 in Exhibit EC-4), BSC and GKN determined the terms on which the joint venture would acquire the assets of the Special Steel Business from BSC and the forging-related assets from GKN. Accordingly, the correct response is that the terms under which UES acquired the BSC assets were negotiated between BSC and GKN.

27. The final question by the Panel concerns whether the owners of UES paid any price for the BSC assets acquired by UES.

28. In one significant sense, the price for the BSC assets was paid by UES since BSC received shares in UES as its compensation for the transfer of the assets to UES. This is the view adopted by USDOC.

29. In another significant sense, since the owners of UES (BSC and GKN) negotiated the terms of the transaction, each of the owners can also be viewed as having "paid the price" for the assets UES acquired from the other owner. In other words, because GKN had to agree on the value of the BSC assets and how much of the ownership of UES should be given to BSC in compensation for BSC's transfer of the assets to UES, GKN can be considered as having "paid the price" for the BSC assets acquired by UES. In the end, there is no functional difference between viewing the transaction as one in which UES paid for the assets or the owners of UES paid for the assets.

30. The EC would further refer the Panel to the following US comments on these issues in the formal record of its investigation and reviews:

- The USDOC Remand Determination of 12 October 1993 states (at page 7) that: *"[t]he Department found that the transaction involving the Special Steels Business was a sale between BSC and UES."*
- The US Government Brief on the case before the US Court of International Trade (US CIT Brief) of 11 February 1994 states (at page 5): *"This case presented Commerce with the novel situation in which a subsidized, state-owned company sold a productive unit to a private party."*
- The US CIT Brief also states at page 6: *"Government-owned BSC sold to United Engineering its Special Steels Business which produced engineering steels, such as lead and bismuth steel products, the subject merchandise in issue. Guest, Keen & Nettlefolds, a privately-owned company, sold to United Engineering its Brymbo Steel Works and its forgings business. In return, United Engineering transferred to each of these respective parties stock of equal value to their assets."* At page 13 the US refers to *"the price United Engineering paid to acquire [the Special Steels Business] from BSC ..."*
- The USDOC verification report for UES of 9 November 1992 describes the GKN-BSC negotiations in some detail at pages 9-12. The official verification report states at page 9 that: *"During the negotiation process, GKN dealt directly with BSC, not with the UK Government, according to company officials."*

Q.13. The US appears to argue that an arm's length privatization transaction at fair market value does not preclude benefit passing through. Suppose a subsidized, government-owned steel company is sold at arm's length for fair market value. Assume that, in the absence of such sale, the only alternative for the purchaser would have been to build a Greenfield plant. However, the cost of building that plant would be much higher than the abovementioned fair market value paid to the government, to the extent that the production of steel would not be viable if a Greenfield plant had to be built. Does the purchaser "benefit" from the fact that there is a subsidized steel plant for sale which, although priced at fair market value, can be bought for less than it would cost to build a Greenfield plant? In other words, is there a

"benefit" because the purchaser is now able to produce steel, whereas it would not have been able to produce steel had it been necessary to construct a Greenfield plant?

31. The EC considers that the cost of construction of a purchased plant (which includes the cost of the land, the building and the machinery on a greenfield site) is not the relevant benchmark. Article 14 ASCM requires that the benefit to the recipient be compared to market benchmarks, not cost of construction benchmarks. For example, Article 14(d), in addressing the sale of goods by governments states that "the adequacy of remuneration shall be determined in relation to prevailing market conditions … including price, quality, availability, marketability, transportation and other conditions of purchase or sale". In no place is there reference to cost of production as a relevant factor so that if a government were to sell goods at below their cost of production but above their market value there would be no subsidy.

32. A simple example demonstrates why the ASCM provides for this market-based approach. Suppose a government sells in the centre of its capital a famous and strategically placed office building. Because of its central position the building has a market value several times its cost of buying the land and building it. If the government were to sell the building with its land at a price reflecting its cost of production (which would be far below its market price) it would be granting a subsidy to the purchaser to the extent of the difference between the purchase price and the market value of the building. If, on the other hand, the situation were reversed in the case of a residential house with a large garden, which has a market value much below what it would cost to buy the land and build, the government would not be granting a subsidy if it sold the house at its market value which would be far below the cost of construction.

33. In the "greenfield" example above, the same principles apply.

Q.14. At its second substantive meeting with the parties, the Panel asked the US the following question:

> **12. With regard to its written reply to written question 11 from the EC, the US notes "that the EC has not raised any claims in this dispute under Article 21.2 of the SCM Agreement". What is the purpose of this note, in light of the EC's claim under Article 10? Does the US suggest that the administrative reviews at issue may only be challenged under Article 21.2 of the SCM Agreement?**

The US replied that it does not suggest that the reviews at issue may only be challenged under Article 21.2 of the SCM Agreement. The purpose of the US note was to suggest that, to the extent the Panel were to look at Article 21.2, and possibly find that the US had somehow violated Article 21.2, the Panel would be precluded from finding a violation of Article 21.2 because it fell outside the Panel's terms of reference (because the EC had not made a claim under Article 21.2). The Appellate Body has made clear that the mere invocation of Article 10 by the EC does not mean that any and all violations of SCM Agreement provisions concerning countervailing duties are now

considered to be alleged. The Appellate Body has made clear that the complaining party must cite the specific provision allegedly violated, and that a violation of a provision cannot be found if the violation of that provision has not been alleged. The US referred the Panel to the Appellate Body reports in Guatemala Cement, India Patents, and Bananas III.

Please comment on the US response.

34. A review can only confirm or modify (include terminating) an original finding which led to the imposition of a countervailing duty under Article 19.1 ASCM. Article 21.2 ASCM requires reviews to be conducted (either on Members' own initiative or upon request by any interested party), but the conditions to be fulfilled before duties can be imposed or maintained remain those of Article 19. For example, Article 19.4 does not allow a countervailing duty to exceed the amount of subsidy found to exist. If Article 19 did not apply to review proceedings Members could impose duties - following reviews - which far exceeded the amount of subsidy.

35. The EC did not allege a breach of Article 21 ASCM since the US did, in fact, conduct reviews. It alleged breaches of Articles 1, 10 and 19 ASCM since the conditions and requirements set out in those provisions were not respected in conducting those reviews.

36. It may be that the US has also violated Article 21 ASCM by not conducting out the reviews it should have conducted or not carrying them out in conformity with Article 21.2 ASCM.

37. The EC has invoked Article 21 in support of its other arguments - as relevant context for the interpretation of other provisions which is entirely admissible and is regularly done in Panel and Appellate Body Reports. The EC would refer the Panel to the distinction made by the Appellate Body in Bananas where it stated that:

> "Article 6.2 of the DSU requires that the *claims*, but not the *arguments*, must all be specified sufficiently in the request for the establishment of a panel in order to allow the defending party and any third parties to know the legal basis of the complaint."[267]

38. Indeed the US seems to arguing that in considering an EC argument based, in part, on Article 21 ASCM, the Panel might find it difficult to avoid implying that the US has violated this provision and that it would this would be tantamount to finding a violation of Article 21. The EC would observe that if this is the US argument, it is invoking its own fault in its favour - something that should not be allowed *(nemo auditur turpidudem suam allegans*). The Panel need not be concerned with the implications that readers may draw from its Report as regards a possible violation of Article 21 ASCM, it need only make clear that it is making no finding on the issue of a direct violation of this provision standing alone.

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[267] Appellate Body Report *European Communities - Regime for the Importation, Sale and Distribution of Bananas* ("EC – Bananas III"), WT/DS27/AB/R, 25 September 1997, DSR 1997:II, 591, para. 143.

Section B - Comments on the issues raised in the questions to the US

Q.2. to the US

Article 19.3 requires CVDs to be imposed on a non-discriminatory basis on imports of the relevant product coming "from all sources found to be subsidized …". Thereafter, Article 19.3 refers to "sources which have renounced any subsidies in question or from which undertakings under the terms of this Agreement have been accepted." Article 18.1 provides for undertakings to be granted by (1) "the government of the exporting Member" and (2) "the exporter".

Does Article 19.3 not suggest that CVDs may only be imposed on imported goods when the "source" of the imported goods is found to be subsidized? If not, why not? Irrespective of your response to the preceding question, are the "sources which have renounced any subsidies in question or from which undertakings under the terms of this Agreement have been accepted" the same "sources found to be subsidized"? If not, why not? If so, what are these "sources"? Please explain whether Article 18.1 is relevant for the purpose of identifying these "sources"?

39. The EC considers that, whatever its historical origins, the phrase "all sources found to be subsidized" in the context of Article 19.3 ASCM can only be referring to producers/exporters. It cannot be referring to productive assets or countries as falsely suggested by the US.

40. Only producers/exporters can renounce subsidies in the sense that the term is used in Article 19.3 and give undertakings.

41. Although Article 18.1 refers to undertakings being offered by and accepted from exporters and governments, governments do not export and so cannot be included in the term "source".

42. The conclusion that the term "source" refers to producers/exporters is confirmed by the immediately following sentence which, as the EC has already observed a number of times, requires a new countervailing duty to be calculated for new exporters.

43. The same conclusion is required if one takes into account the use of the term in the equivalent provision in the antidumping agreement. Article 9.2 Antidumping Agreement provides that :

> "… anti-dumping duty shall be collected in the appropriate amounts in each case, on a non-discriminatory basis on imports of such product from all sources found to be dumped and causing injury, except as to imports from those sources from which price undertakings under the terms of this Agreement have been accepted."

44. Only companies can give antidumping undertakings and so the term "sources" can only refer to companies.

Q.4. to the US

In its written reply to written question 6 from the EC, the US explains why it believes that the issue of whether a financial contribution continues

to confer a benefit involves an effects test. If this is the case, wouldn't the assessment required by Article 21.3 (i.e., whether the expiry of CVDs would be likely to lead to "continuation" of subsidization) also involve an effects test? Is it possible to determine whether there is a likelihood of continued subsidization without examining whether there is a likelihood of continued benefit?

45. In the discussion relating to the question of how to assess the continuing benefit from a financial contribution the US confirmed that it would never re-evaluate the originally assessed benefit even if the assumptions on the basis of which the benefit was originally determined had changed. The discussion of the case of advantageous government loans well illustrated the inadequacy of the US approach and the fact that it did not comply with the requirements of the ASCM.

46. If the government offers a company a loan repayable at will at an advantageous interest rate compared with what the company would otherwise have had to pay, it is clearly bestowing a subsidy. This is also a subsidy that has a lasting effect over the duration of the loan and which could therefore be countervailed over that period.

47. The US would attempt to measure the total amount of the benefit when the loan is first made and then allocate it over the amortization period and subsequently irrebuttably deem the benefit in any year to be the relevant part of the "allocated benefit stream". This would give rise to the absurd result that if market conditions or the company's credit rating were to improve so that the company could after a number of years borrow on the market at a more favourable rate than that of the loan, the US would continue to countervail its deemed "allocated benefit stream". A further absurd result is that, according to the US, the countervailing duties would cease if the loan were repaid and an identical loan taken from the private sector, whereas they would continue if the company continued with the original loan.

48. The ASCM clearly requires the subsidization and therefore the benefit to be established in the relevant POI or POR. The correct approach and the one that the EC would apply would be to consider the amount of the benefit and therefore the subsidy to be the difference between the payments under the loan and the corresponding market amount in the POI or POR.

Q.7. to the US

At para. 20 of its second written submission, the US asserts that neither Articles 1 nor 14 "is intended as an indication of whether the financial contribution will benefit the `legal person' who received the financial contribution". The Panel notes that Article 14 (b) provides that a government loan confers a benefit when "the firm receiving the loan" receives the loan on terms more favourable than a comparable commercial loan. A similar approach is adopted in Article 14(c). Furthermore, the chapeau of Article 14 refers to benefit to the "recipient". Do these provisions not support the view that Article 14 focuses on benefit to the legal person, by determining whether the legal person received government assistance on terms more advantageous than those it could have obtained on the market?

Furthermore, the US explained at para. 80 of its first written submission that equity infusions to BSC conferred a benefit because BSC was unequityworthy. Does this not support the view that the US determined benefit to BSC, i.e., the legal person, by determining whether BSC obtained equity on terms more advantageous than those it could have obtained on the market?

49. The US answer to this question relied on the absurd contention that "benefit to the recipient" was a term used in US countervailing duty law and was really shorthand for benefit to the merchandise. Whether this is true or not is a question of US law that need not concern the Panel. The real point is that "benefit to the recipient" is a clear term used in the ASCM and agreed to by all WTO Members. It has its own plain meaning which is unaffected by any suddenly revised meaning that the US may attempt to claim in the current proceeding.

50. The fact that the US based its calculation of the subsidy to British Steel Corporation in large part on the notion that it was "unequityworthy" further underlines the fallacy of the US approach. USDOC never asked itself the question whether UES or British Steel Plc were "unequityworthy" - it simply deemed the benefit to be the relevant part of the "allocated benefit stream" that it calculated for British Steel Corporation.

Q. 9. to US

Please comment on the argument at para. 48 of the EC's second written submission that "[t]he fact that recipients of subsidies must be persons rather than goods is confirmed by the text of Article 2.1 ASCM, which lays down the fundamental requirement of specificity of the subsidy to certain enterprises …".

51. The US denies that Article 2.1 ASCM is context for the purpose of interpreting Article 1.1 ASCM since it is not addressing the question of who or what receives the subsidy.

52. The EC cannot accept this argument. Article 2.1 addresses the question of to whom the subsidy is to be provided for the disciplines of the ASCM to apply. Different provisions always address different questions otherwise they would be redundant. That does not stop them from being relevant context for each other, especially when they use the same terms.

Q.16. to US

In its written reply to written Panel question 9, the US "rejects the notion that subsidies 'attach' to assets or to companies …" In the 1995 administrative review at issue, USDOC stated that "when BSC sold its Special Steels Business, that productive unit took a portion of the benefits with it." Is USDOC's statement consistent with the above-mentioned extract from the US response to written Panel question 9? If so, please explain how. Furthermore, please explain how the Special Steels Business "productive unit took a portion of the benefits with it" if those "benefits" were not attached to that "productive unit".

53. The US is unable to provide any rational explanation of how untied subsidies can attach to or "travel with" assets. Its explanations refer to the need to "capture" subsidies, to the conviction that subsidies cannot disappear and the need to address market distortions, which it never even established or claimed during the investigations themselves.

54. These explanations demonstrate that the US has adopted its "pass through " approach to pre-privatization subsidies in a protectionist attempt to shield its domestic industry from market-based private competitors who enjoy no subsidy. The US seeks to avoid any possibility that protection once obtained can be lost or "circumvented" because of subsequent changes in the exporters.

55. These are not proper objectives under the ASCM. Market distortions such as the creation of capacity may exist for all sorts of reasons - including the activities of private rich uncles - but the ASCM is clear that offsetting countervailing duties are not an appropriate remedy. The ASCM only allows countervailing duties to be applied to the products of a producer or exporter who has actually received a subsidy within the meaning of Article 1 of the ASCM.

56. There is no basis in the ASCM for holding that once a domestic industry has obtained countervailing duty protection this must continue throughout an amortization period in all circumstances and in all situations.

57. Subsidies can be removed or "disappear". They can be repaid. The beneficiary can go bankrupt or its assets be destroyed by a war. Similarly, the producer could stop any business activity and sell its assets to others. Such fundamental changes in circumstances require a examination of the existence of subsidization and if none is found there is no basis for applying countervailing duties. The US is violating the ASCM by refusing to admit this and clinging to the belief that subsidies automatically pass through. In the US view articulated to the Panel, someone, even an unrelated private purchaser of assets paid for at arm's-length fair market value, must pay a duty despite the complete absence of any benefit to countervail with offsetting duties.

58. "Circumvention" of otherwise appropriate duties is, of course, not even relevant in the present case. The sale to UES and the privatization of British Steel Corporation were transactions that were completed years before there was any suggestion of countervailing duty action by the US.

59. Contrary to one of its claimed purposes, the current US "pass through" practice actually encourages opportunities for circumvention.

60. If it is possible for untied subsidies to travel with assets, it becomes possible for producers with countervailing duty liability to reduce it by trading in productive units. The simplest example is the swapping of productive units between an exporter and a non-exporter. The sale of the original productive unit will reduce the pool of subsidies for the exporter since part will travel with the assets according to the US approach, as the US expressly confirmed during discussion of this question. The purchase of an equivalent productive unit from a company not subject to countervailing duty liability will further reduce the rate of countervailing duty liability since the reduced pool of subsidies will be spread over more assets.

Q.17. In the context of the privatization of government-owned assets, the Panel understands that the reason why USDOC considers it necessary to apply its change-in-ownership methodology is because "a private party purchasing all or part of a government-owned company (e.g., a productive unit) can repay prior subsidies …" (GIA, page 37262). A similar statement was made in the US written reply to the Panel's written question 8. Is this understanding correct? If not, please explain why USDOC applies its change-in-ownership methodology in the case of (full or partial) privatization.

In its written reply to written question 12 from the Panel, the US asserted that the USDOC change-in-ownership methodology would apply when privately-owned assets are sold to private companies, but that any subsidies bestowed on the assets before sale would not be repaid through the sale ("because the seller is not the government"). What is the justification for applying the change-in-ownership methodology in the case of a transaction between two private parties? Presumably, USDOC does not do so because of the potential repayment of subsidies.

61. The EC would merely observe that in an arm's length transaction between private parties it is not possible to argue that the seller has somehow passed on a benefit to the purchaser as this would imply that the seller did not realize the full value of the assets he sold.

For the term "repayment" to be appropriate a subsidy must first actually exist. The US automatically and irrebuttably assumes this by refusing to examine the sale transaction at issue. The Panel is correct that in a rational world with a rational methodology USDOC should not consider private-to-private transactions as "repaying" subsidies. It can only do by considering that subsidies automatically live in and travel with assets and *never* examining the actual transaction. It assumes a subsidy which does not exist.

Q.24. to the US

At para. 93 of its second oral submission, the US cites to extracts from an article by Mr. Hufbauer's. The first paragraph of that extract states that "whether British Steel's new owners benefitted from the prior subsidies has no bearing on the competitiveness of the steel mills - which the subsidies pumped up massively." Please give the full title of the entity described as "British Steel" in this extract. Whose "competitiveness" has been "pumped up". Is it the fact that an entity's "competitiveness" has been "pumped up" that demonstrates the existence of "benefit" within the meaning of Article 1.1(b) of the SCM Agreement?

In his article (Exhibit USA-40), Mr. Hufbauer states that "[a]ssuming British Steel shares were fairly priced, the government's financial position was unchanged by the sale. So how can it have been repaid for the prior subsidies?" We understand Mr. Hufbauer to argue that the privatization of BSC could not have led to the repayment of subsidies conferred on BSC. How is this consistent with the US assertion at para. 95 of its first written submission that "[t]he portion [of BSC subsidies] allocated to the U.K. government was considered to have been repaid to the government …"?

62. Mr. Hufbauer's reasoning is essentially based on the discredited "rich uncle" market distortion hypothetical set forth in the US First Written Submission.[268] Unfortunately, Mr. Hufbauer appears to have been misinformed regarding several central facts of this dispute by the USDOC and this colours his opinion.

63. Mr. Hufbauer asserts that "privatization does not erase distortions" and declares this the " nub" of the dispute.[269] Yet, in response to Question 13 from the Panel after the First Substantive Meeting, the US appropriately backed away from its initial sweeping and *legally unbounded* claim that the purpose of *countervailing duties* is to cure alleged market distortion and deter subsidy. The US states at paragraph 46 that "[t]he SCM Agreement permits countervailing duties to offset subsidies, ***not*** the amount of economic distortion caused by subsidies." (emphasis added). The US further asserts in its own GIA that:

> "[I]t does not follow that the statute requires us to somehow 'correct' market distortions which may have occurred due to the provision of subsidies beyond countervailing the benefits received. The CVD law is designed to provide remedial relief as a result of subsidies; it is not intended to recreate the *ex ante* conditions that existed prior to the bestowal of such subsidies ... The fact that productive capacity may have been created or continues to exist is an irrelevant inquiry and beyond the scope of the law".[270]

64. These statements, with which the EC broadly agrees, are a long way from the US " rich uncle" hypothetical.

65. Mr. Hufbauer further offers no analysis of *benefit* to the privatized company, instead apparently arguing that their mere existence entitles them to be countervailed. He then discusses daily share sales of a few shares which are not at issue *at all* in this case. Lastly, and perhaps most revealingly, Mr. Hufbauer notes:

> "[O]nce a nation abandons socialism, its exports are free from US countervailing duties unless the government slips back into subverting market mechanisms with new subsidies - a temptation countervailing duties are intended to deter."

66. Of course, in the dispute before the Panel nothing approaching this description happened. *All* alleged financial contributions were to the state-owned British Steel Corporation prior to its arm's-length privatization. None were made to British Steel plc. However, the exports of the private British Steel plc, privately purchased at arm's-length for fair market value, were not "freed" from US countervailing duties. Instead benefits were *automatically and irrebuttably* presumed to exist by USDOC, when demonstrably no such benefit exists. Further, as the EC have noted at length, the purpose of *countervailing duties is* set forth *explicitly* in Article 10, footnote 36 ASCM. They are "special" duties for the pur-

[268] US First Written Submission at para. 223; EC Second Written Submission at paras. 64-68.
[269] Exhibit USA-40 at para. 1.
[270] See GIA at page 37264.

pose of *"offsetting"* subsidy. The unbounded concept of deterrence is found nowhere in Part V ASCM.

67. While one easily identifies several factual flaws (as well as several contradictions with the US' own statements on the record in this very dispute) in the Hufbauer article, the US offers no concrete rebuttal of the conclusions drawn by Dr. Cooper. Instead, the US informs the Panel that Dr. Cooper's economic analysis "*only* analyzes the privatization transaction from the perspective of the *new owner* of the successor, privatized company."[271] This is, of course, false, and, the US again draws a fake distinction here that it does not even recognize itself with respect to privatization. The US identifies no citation for its assertion, perhaps because Dr. Cooper explicitly notes in his analysis that:

> "Basic economic analysis establishes that no economic benefit is enjoyed by the now-privatized producer of the goods, a productive unit thereof, or the merchandise itself, in comparison to competitors in the marketplace.[272]
>
> For the benefit of prior government financial contributions to "pass through" to the new buyer/company/merchandise, the seller would have to act in an economically irrational manner and forgo income by agreeing to a price lower than fair market value.[273]
>
> From the perspective on analyzing whether any benefit is enjoyed *by the privatized company*, however, this inquiry is the most fundamental economic issue.[274]
>
> US countervailing duty practice ensures that countervailing duties will be assessed as financial penalties on *privatized firms that enjoy no economic benefit from government contributions* provided to state-owned predecessors.[275]
>
> When a buyer pays fair market value at arm's length, no economic advantage is conveyed *to the buyer, the assets purchased by the buyer, or the goods produced with those assets*. The buyer has paid fully for everything it has received.[276] "

[271] US Second Oral Statement at para. 92 (emphasis in the original).
[272] See Exhibit EC-13 at page 1.
[273] Ibid. at page 2.
[274] Ibid. at page 3 (emphasis added).
[275] Ibid. at page 4 (emphasis added).
[276] Ibid. at page 4 (emphasis added).

ATTACHMENT 2.1

FIRST WRITTEN SUBMISSION OF THE UNITED STATES
18 May 1999

TABLE OF CONTENTS

I. INTRODUCTION AND SUMMARY OF ARGUMENT

1. The challenges raised by the European Communities ("EC") in this matter relate to determinations made by the US Department of Commerce ("USDOC") in three successive annual administrative reviews of the countervailing duty order covering imports of certain hot-rolled lead and bismuth carbon steel products (referred to herein as "lead bar" products) from the United Kingdom ("UK").

2. The USDOC determinations at issue concern more than *£7 billion* of UK Government subsidies bestowed on British Steel Corporation ("BSC"), a government-owned company, prior to three change-in-ownership transactions in which BSC later was involved. In the first of these transactions, in 1986, BSC

spun off lead bar-producing assets from its Special Steels Business to an independent joint venture, which became known as United Engineering Steels ("UES"). The second transaction took place in 1988, when the UK Government privatized BSC, which then became known as British Steel plc ("BS plc"). In the third and final transaction, which took place in 1995, BS plc re-acquired UES.

3. The EC's challenges are directed at USDOC determinations allocating a portion of the massive BSC subsidization - UK.. government equity infusions and grants - to the production of the UES joint venture and, later, BS plc.

4. As the United States shows below, in addressing the massive BSC subsidization, USDOC adhered strictly to the provisions of the Agreement on Subsidies and Countervailing Measures ("SCM Agreement"), to the extent that those provisions addressed matters relevant to this issue. In addition, where the SCM Agreement did not provide direct guidance, USDOC approached its task permissibly and in a manner that was fully consistent with the object and purpose of the SCM Agreement.

5. As contemplated by the SCM Agreement, USDOC first sought to *identify* the existence of potentially countervailable subsidies. Addressing each of the alleged subsidies in turn, USDOC applied Article 1.1 of the SCM Agreement and found the existence of a "subsidy," i.e., a "financial contribution" which thereby conferred a "benefit." USDOC also addressed whether these subsidies were "specific" as required by Article 1.2, and it found that they were. USDOC therefore considered these subsidies to be countervailable.

6. Next, USDOC *measured* the "benefit" of each of the subsidies in a manner consistent with the guidelines set forth in Article 14. Thus, with regard to the equity infusions, USDOC followed Article 14(a) and examined the usual investment practice as of the time of the equity infusions in order to come up with an appropriate measurement of their benefits. In addition, although Article 14 does not address grants, USDOC followed the general principles of Article 14 and looked only at the time of the subsidy bestowals to measure the grants' benefits, which were simply the amounts of the grants.

7. The next step for USDOC under its practice was to *allocate* the measured benefits over time, meaning to future production of what USDOC terms the "subject merchandise," i.e., the lead bar products. The SCM Agreement itself does not address how or even under what circumstances a subsidy should be allocated over time, although it does generally recognize the principle that subsidies may be allocated over time, as can be seen from Annex IV, for example. In any event, USDOC applied its normal allocation methodology, which is consistent with similar methodologies applied by other WTO Members, including the EC. Given the record facts, USDOC's application of this methodology resulted in an amortization of the benefits over a time period of 18 years. In other words, for each subsidy, USDOC created an 18-year benefit stream, with the net present value of the subsidy benefits being divided between each of the 18 years pursuant to a standard declining balance formula.

8. In its final step, USDOC addressed the changes in ownership at issue. Here, there was no direct guidance from the SCM Agreement, at least in the context of a WTO Member's countervailing duty proceeding under Part V of the

SCM Agreement. Thus, USDOC had to decide *whether* and, if so, *how* to take into account the changes in ownership at issue, which occurred years after the original subsidy bestowals but well before the end of the relevant 18-year allocation periods. USDOC followed its existing change-in-ownership methodology, which reflected USDOC's decision to take into account a change in ownership essentially through the application of a second allocation methodology.

9. The basic principle underlying USDOC's methodology is that US countervailing duty law, like the SCM Agreement, focuses on how a subsidy benefits the production of merchandise and does not envision ever re-visiting the original determination of the existence of a subsidy benefit, which is made as of the time of the subsidy bestowal. This principle rules out an approach, like that being advocated by the EC in this dispute, which is founded on a re-valuation of the benefit as of a time that was years after the subsidy bestowal.

10. What USDOC's methodology does is to take into account the change in ownership by re-allocating the subsidy benefit. Specifically, it takes the benefit which had already been allocated over time under USDOC's normal allocation methodology and, based on the price that the purchaser paid for the company, among other things, further allocates the benefit - or, perhaps more precisely, apportions it - between the seller and the purchaser. As an example, if USDOC's normal allocation methodology had allocated £100 million of subsidy benefits to a particular year of the allocation period, USDOC's change-in-ownership methodology may have further allocated the £100 million of subsidy benefits between the seller and the purchaser so that, for that year, £40 million would be allocated to the seller and £60 million would be allocated to the purchaser.

11. Notably, USDOC's approach to the changes in ownership at issue in this dispute is consistent with the approach suggested by Article 27.13 for WTO subsidy challenges under Part III of the SCM Agreement, where the implied rule is that subsidies bestowed on a government-owned company's production prior to privatization are actionable and remain allocable to the privatized company's production.

12. During the first half of the three one-year periods of review ("PORs") at issue, which were the years 1994, 1995 and 1996, the UES joint venture alone produced the subject merchandise. Thus, after performing the analysis discussed above and applying USDOC's change-in-ownership methodology, USDOC countervailed the *portion* of the subsidies originally bestowed on BSC's production which were allocable to the production of the UES joint venture following its spin-off from BSC. For the remainder of the review periods, when BS plc was the sole producer of the subject merchandise (because it had re-acquired the UES joint venture), USDOC applied the same analysis, including its change-in-ownership methodology, and countervailed the *portion* of the original BSC subsidies that were allocable to BS plc production following BSC's privatization as well as the *portion* of the original BSC subsidies that re-joined BS plc following BS plc's re-acquisition of UES.

13. Before this Panel, the EC attempts to discredit USDOC's approach to changes in ownership essentially by urging the adoption of two rules which it views as being *required* by the SCM Agreement. The first rule is that the investi-

gating authority is required to identify and measure the *continuing* benefit of a subsidy as of a point in time that may be years after its bestowal, such as when the ownership of the subsidy recipient changes hands. The second rule, which would become relevant only if the Panel were to accept the first rule, is that a change in ownership accomplished through an arm's length, fair market value transaction by definition eliminates all previously bestowed subsidies. The EC explains that, as an economic matter, the purchaser has paid exactly what the subsidies are worth at the time of the change-in-ownership transaction, and therefore it realizes no continuing benefit - or, in the EC's words, no continuing "commercially meaningful advantage" - from the subsidies within the meaning of Article 1.1(b) of the SCM Agreement.

14. In the EC's view, this approach is the only one that is permissible under the SCM Agreement.

15. The result in this dispute, under the EC's scenario, would be no allocation of subsidies to either the UES joint venture or BS plc and therefore no levying of countervailing duties. When the EC's proposed rules are applied to the record facts, the *£7 billion of subsidies* bestowed on BSC's production by the UK Government simply vanish because the changes in ownership at issue took place in arm's length, fair market value transactions.

16. The EC's argument is unsupportable, both in its failure to establish the relevant legal prerequisites under the SCM Agreement and in the misplaced and inaccurate economic assumptions on which it also depends.

17. Fundamentally, it is the provisions of the SCM Agreement that must determine whether the USDOC determinations at issue are permissible. The EC, however, has offered no sound basis under the SCM Agreement for overturning them.

18. The key *legal* point that the EC must demonstrate to support its proposed rules is that the SCM Agreement requires the investigating authority to identify a subsidy "benefit" within the meaning of Article 1.1.(b) not just as of the time of the original subsidy bestowal, but also a second time - here, as of the time of a change in ownership. In attempting to make this demonstration, however, the EC does not focus on the ordinary meaning of the provision dealing directly with the identification of the subsidy benefit - namely, Article 1.1 - nor does it focus on the ordinary meaning of Article 14, which provides context for Article 1.1 when it addresses the measurement of the subsidy benefit. Instead, the EC seeks support for its proposed rules principally in what it views as the object and purpose of the SCM Agreement, which it derives from Articles 10 and 19.4. The EC (erroneously) states this object and purpose as the imposition of duties to offset the *continuing* subsidy benefit received by *the firm under investigation* in a countervailing duty proceeding. The EC then reads this object and purpose into Articles 1.1 and 14 as support for a *requirement* that the investigating authority must re-*identify* a "benefit" as of a time that may be years after the bestowal of the subsidy, such as when the ownership of a subsidized recipient changes hands.

19. In this dispute, the controlling legal principle is that the SCM Agreement only contemplates that the investigating authority will identify a subsidy "benefit" under Article 1.1(b) once, as of the time of the subsidy bestowal. The SCM

Agreement does not *require* that the investigating authority make this determination a second time, either generally or in the circumstances where the ownership of the subsidy recipient has changed hands. The SCM Agreement simply does not envision the investigating authority attempting to determine whether there exists a benefit on a *continuing* basis. Rather, it contemplates that a subsidy bestowed on the production of, for example, lead bar will be countervailable against lead bar imports until fully amortized, regardless of whether, how often or at what price ownership of the subsidized production changes hands. For this reason, contrary to the EC's position, USDOC's methodology does not violate the SCM Agreement by virtue of the fact that it only identifies the benefit as of the time of the subsidy's bestowal.

20. A careful review of the SCM Agreement shows that it simply does not dictate what methodology USDOC must follow in accounting for subsidies bestowed prior to a change in ownership. Rather, the SCM Agreement leaves the selection of an appropriate methodology largely to the discretion of the Member's investigating authority.

21. Given these circumstances, USDOC permissibly dealt with a situation for which the SCM Agreement provided no direct guidance. USDOC applied a methodology that is grounded in fundamental SCM Agreement principles set forth in Article 1.1 and Article 14 and is consistent with the real object and purpose of the SCM Agreement, which is to deter and offset trade-distorting government subsidies benefiting merchandise and causing injury to an industry in an importing country.

22. The SCM Agreement certainly does not *require* the competing approach advocated by the EC, which calls for an examination of whether there exists any *continuing* benefit from the previously bestowed subsidies as of the time when the ownership of the subsidy recipient changes hands. As explained above, the SCM Agreement simply does not envision the investigating authority attempting to determine whether there exists a benefit on a *continuing* basis.

23. Indeed, it is questionable whether the EC's approach is even permissible under the SCM Agreement. By calling for an examination of whether a benefit exists on a *continuing* basis, the EC's approach asks the investigating authority to inquire into the *effects* of subsidies. The SCM Agreement, however, does not contemplate any inquiry into the effects of subsidies outside the Article 15 "injury" context (in the case of a countervailing duty proceeding) or the Article 5 "adverse effects" context (in the case of a WTO dispute). Indeed, if this Panel were to require the EC's proposed effects inquiry, it would be making a fundamental change in the SCM Agreement's approach to the identification of subsidies, and that change would seriously undermine the effectiveness of the SCM Agreement's agreed disciplines on subsidies. If it became necessary to establish a continuing benefit before imposing countervailing duties, as suggested by the EC's argument, an importing Member's ability to remedy the trade distortions caused by another Member's subsidies would be significantly circumscribed, given the difficulties inherent in any attempted showing of the effect of a subsidy on the subsidy recipient as of a time that may be years after its bestowal.

24. Furthermore, independent of these legal infirmities, it bears noting that the economic component of the EC's argument is not only overly simplistic, but it is also, more fundamentally, misplaced. Moreover, its is an economic component that the EC conspicuously ignores in its own internal regime for disciplining subsidies. Constricted by the EC's misinterpretation of the object and purpose of the SCM Agreement as the imposition of duties to offset the continuing subsidy benefit received by the firm under investigation in a countervailing duty proceeding, the EC's economic analysis adopts the wrong focus. It focuses on the purchaser and, in particular, the effects which an arm's length, fair market value privatization transaction has on the purchaser. The more appropriate focus of any analysis of the economics of privatization should be on market distortions, in recognition of the SCM Agreement's basic object and purpose of deterring and offsetting trade-distorting government subsidies benefiting merchandise and causing injury to an industry in the importing country. In a heavily subsidized industry like the steel industry, such things as excess capacity, often brought on by the very same massive government subsidization which the EC assumes away, can distort the market tremendously, both in terms of the value of firms and in terms of the price for outputs. These distortions are not cured by an arm's length, fair market value sale of a heavily subsidized government-owned company.

25. Consequently, for all of these reasons, and as explained in more detail below, the Panel should reject the EC's challenge and find that the United States did not violate the SCM Agreement when making the determinations at issue.

II. PROCEDURAL BACKGROUND

26. On 12 June 1998, the EC requested World Trade Organization ("WTO") consultations with the United States regarding the imposition of countervailing duties in the context of three successive administrative reviews of the countervailing duty order covering imports of lead bar products from the United Kingdom .[277]

27. The three USDOC determinations at issue were (a) the final results of the third administrative review of the countervailing duty order covering imports of lead bar products from the United Kingdom, also known as the 1994 review,[278]

[277] WT/DS138/1. Unlike the systems of some WTO Members, the United States uses a "retrospective" assessment system under which final liability for countervailing duties is determined after merchandise is imported. Generally, the amount of duties to be assessed is determined in an "administrative review" of the countervailing duty order covering a discrete period of time, usually one year, known as the period of review, or POR. Prior to a particular "administrative review," the importer pays a non-final estimate of the duties based either on the original countervailing duty investigation or a prior administrative review.

[278] *Final Results of Countervailing Duty Administrative Review; Certain Hot-rolled Lead and Bismuth Carbon Steel Products from the United Kingdom,* 61 Fed. Reg. 58377 (14 Nov. 1996) (cited herein as "1994 Review") (attached as Ex. USA-1).

(b) the final results of the fourth, or 1995, administrative review,[279] and (c) the final results of the fifth, or 1996, administrative review.[280]

28. In its consultations request, the EC stated that USDOC's determinations in the three reviews constituted breaches of US WTO obligations under Articles 1.1(b), 10, 14 and 19.4 of the SCM Agreement.

29. Consultations were held on July 29, 1998, but failed to settle the dispute.

30. On 14 January 1999, after the one round of consultations, the EC requested establishment of a panel pursuant to Article 4 of the Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU"), Article XXII:1 of the General Agreement on Tariffs and Trade 1994 ("GATT 1994") and Article 30 of the SCM Agreement.[281] In its panel request, the EC challenged the three measures addressed by its consultations request - USDOC's determinations in the 1994, 1995 and 1996 administrative reviews of the countervailing duty order covering imports of lead bar from the United Kingdom - as well as one new measure, namely, USDOC's 1993 decision to impose countervailing duties as a result of its original investigation of UK lead bar imports,[282] which pre-dated the coming into force of the Marrakesh Agreement Establishing the World Trade Organization ("WTO Agreement"). The EC claimed that these four measures violated the WTO provisions cited in its earlier consultations request.

31. On 25 January 1999, the EC submitted a "corrigendum" to its panel request in which it sought to clarify the reasoning for its challenges to these measures.[283]

32. A panel was established at the meeting of the Dispute Settlement Body ("DSB") held on 17 February 1999.

33. Standard terms of reference, incorporating the January 14 panel request and the 25 January corrigendum, were established on 9 March 1999.

34. Brazil and Mexico have reserved their rights as third parties in this dispute.

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[279] *Final Results of Countervailing Duty Administrative Review; Certain Hot-rolled Lead and Bismuth Carbon Steel Products from the United Kingdom*, 62 Fed. Reg. 53306 (14 Oct. 1997) (cited herein as "1995 Review") (attached as Ex. USA-2).

[280] Ibid. (15Apr. 1998) (cited herein as "1996 Review") (attached as Ex. USA-3).

[281] WT/DS138/3. In its panel request, the EC alleged violations of Articles 1.1(b), 10, 14, and 19.4 of the SCM Agreement. However, in its first submission, the EC only alleged violations of Articles 10 and 19.4 of the SCM Agreement. *See, e.g.*, EC's First Submission, para. 139.

[282] USDOC's final determination in the investigation of UK lead bar products - the decision that lead to the imposition of a countervailing duty order - is found in *Final Affirmative Countervailing Duty Determination; Certain Hot-rolled Lead and Bismuth Carbon Steel Products from the United Kingdom*, 58 Fed. Reg. 6237 (27 Jan. 1993) (attached as Ex. USA-4). In ensuing litigation before the US Court of International Trade, USDOC voluntarily reconsidered its final determination and modified its change-in-ownership methodology to coincide with the methodology that it subsequently had used in the General Issues Appendix of *Final Affirmative Countervailing Duty Determination; Certain Steel Products from Austria*, 58 Fed. Reg. 37217, 37269 (9 July 1993) ("General Issues Appendix") (attached as Ex. USA-5). *See* Final Results of Redetermination Pursuant to Court Remand in *Inland Steel v. United States*, Consol. Court No. 93-04000234 (CIT), dated 12 Oct. 1993, at 2-4 ("*Remand Determination*") (attached as Ex. USA-6).

[283] WT/DS138/3/Corr. 1.

35. The United States notes that, in its First Submission, the EC only challenges the final results of the 1994, 1995 and 1996 administrative reviews. Although its panel request suggested that it was also challenging the USDOC decision that lead to the imposition of the countervailing duty order, i.e., USDOC's 1993 final determination, the EC has not done so, presumably because that decision pre-dated the SCM Agreement and therefore cannot be challenged under the SCM Agreement. Under these circumstances, the United States reserves the right to object to any future challenge that the EC may make to that decision in this proceeding.

III. FACTUAL BACKGROUND

A. USDOC's Change-In-Ownership Methodology[284]

36. In this case, USDOC used its change-in-ownership methodology to determine how to treat the subsidies received by BSC prior to the various changes in ownership at issue, including its own privatization. USDOC has explained the rationale for this methodology in some detail over the years, with the fullest explanation being found in the pre-Uruguay Round General Issues Appendix,[285] which USDOC referenced and endorsed in the challenged, post-Uruguay Round administrative reviews.

37. USDOC's change-in-ownership methodology is based on fundamental principles of the US countervailing duty law, and these same principles are found in the SCM Agreement.

38. The starting premise of the methodology is that while subsidies are considered to be "distortions in the market process for allocating an economy's resources,"[286] it is neither required nor feasible for the investigating authority to show how those distortions may have occurred in any particular instance of subsidization. As USDOC explained in the General Issues Appendix, which construed the US countervailing duty statute as it existed prior to the Uruguay Round,

> [n]othing in the statute directs the Department to consider the use to which subsidies are put or their effect on the recipient's subse-

[284] USDOC's change-in-ownership methodology is addressed in this section of the United States' submission because it is an accepted principle of international law that municipal law and practice is a fact to be proven before an international tribunal, such as this Panel. *Case Concerning Certain German Interests in Polish Upper Silesia* [1926], PCIJ Rep., Series A, No. 7, at 19 (attached as Ex. USA-7)*; Case Concerning the Payment in Gold of Brazilian Federal Loans Contracted in France* [1929], PCIJ Rep., Series A, No. 15, at 124-25 (attached as Ex. USA-8). *See also* I. Brownlie, *Principles of Public International Law*, 4th ed. (Clarendon Press 1990), pp. 40-42 (attached as Ex. USA-9). Consequently, this Panel should review each party's presentation of the relevant facts - here, the United States' change-in-ownership methodology - and be guided by the Appellate Body's recent statement in the *Wool Shirts* case, i.e., "the party who asserts a fact, whether the claimant or the respondent, is responsible for providing proof thereof." Appellate Body Report *US - Wool Shirts and Blouses*, WT/DS33/AB/R, adopted 23 May 1997, DSR 1997:I, 323, at 335.

[285] *See* note 6 *supra*.

[286] General Issues Appendix, 58 Fed. Reg. at 37260.

> quent performance ... . Nothing in the statute conditions countervailability on the use or effect of a subsidy. Rather, the statute requires the Department to countervail an allocated share of the subsidies received by producers, regardless of their effect.[287]

39. Consequently, under US countervailing duty law, USDOC identifies whether a "benefit" exists once, which is as of the time of the alleged subsidy bestowal. Subsequent uses or effects of the subsidy funds, or subsequent events in the marketplace, are irrelevant to this determination. As the United States explains below in Part IV.B.1.a., Article 1.1 of the SCM Agreement reflects this same approach.

40. Building on this principle, which continues to be applicable under the United States' post-Uruguay Round countervailing duty law according to USDOC[288] and the US courts,[289] USDOC reasons:

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[287] General Issues Appendix, 58 Fed. Reg. at 37260. At one point in its First Submission, the EC notes that the purpose of the US countervailing duty law has been expressed as "to offset the unfair competitive advantage that foreign producers would otherwise enjoy from export subsidies paid by their governments." EC's First Submission at 31 n.68 (quoting *Zenith Radio Corp. v. United States*, 437 US 443 (1978)). The EC seems to use this quotation to suggest that US countervailing duty law does, in fact, look into the actual effect of a subsidy on the subsidy recipient and, specifically, into whether there exists a *continuing* benefit at some point after the subsidy's bestowal. To the contrary, however, as USDOC explains in the General Issues Appendix, neither the US Congress nor the courts have ever required it to make an inquiry into the use or effect of a subsidy, and it does not do so. *See* General Issues Appendix, 58 Fed. Reg. at 37260-61.

[288] As is explained in Final Results of Redetermination Pursuant to Court Remand in *Delverde, SrL v. United States*, Consol. Court No. 96-08-01997 (CIT), dated April 2, 1998, at 35-41 ("*Delverde Remand Determination*") (attached as Ex. USA-10), although the requirement that a subsidy confer a "benefit" upon the recipient in order to be countervailable was expressly included in the US countervailing duty statute for the first time following the Uruguay Round and the coming into force of the SCM Agreement, the requirement is not new to US countervailing duty law. It has long been established as a fundamental principle of US countervailing duty law that there must be a benefit, and USDOC has applied this principle in *every* countervailing duty proceeding that it has ever conducted. Specifically, since USDOC began implementing the US countervailing duty statute in 1980, USDOC through its practice has defined a "subsidy" as (a) an act or practice of a foreign government, normally referred to as a "programme," (b) which confers a "benefit" on the recipient. A subsidy becomes a countervailable subsidy if it is also "specific" to an enterprise or industry or a group of enterprises or industries, a concept which has been referred to as "selective treatment." This definition was set forth in Section 355.42 of USDOC's first set of proposed substantive regulations in the countervailing duty area, issued in 1989, which attempted to re-state USDOC's practice up to that point. *See* Notice of Proposed Rulemaking and Request for Public Comments (Countervailing Duties), 54 FR 23366, 23374 (31 May 1989) ("*1989 Proposed Regulations*") (emphasis added) (attached as Ex. USA-11). The term "benefit" was defined, in turn, in Section 355.44 of the 1989 Proposed Regulations, although it did so by way of example rather than through a generic statement, much like Article 14 of the SCM Agreement. Thus, this section describes grants, below-market rate loans, equity infusions made on terms inconsistent with commercial considerations, the provision of goods or services at preferential rates, and the like. *See 1989 Proposed Regulations*, 54 FR at 23380-83. Following the Uruguay Round, USDOC continued to follow the same requirement that a subsidy confer a benefit on the recipient, although this requirement now appeared in the US countervailing duty statute itself (in Section 771(5)(B)), which had been amended to comply with the SCM Agreement. The Statement of Administrative Action ("SAA") accompanying the amendments to the statute explains this point:

> In general, the Administration intends that the definition of 'subsidy' will have the *same meaning* that administrative practice and courts have ascribed to the term ...

> [W]hether subsidies confer a demonstrable competitive benefit upon their recipients, in the year of receipt or any subsequent year, is irrelevant - the statute embodies the irrebuttable presumption that subsidies confer a countervailable benefit upon goods produced by their recipients.[290]

USDOC added that this "statutory presumption ... must, in order to have the intended effect, be applied over a reasonable period of time," just as the Department "allocates non-recurring subsidies over time in recognition of the fact that the statutory goal of providing a remedy against subsidies would be defeated by allocating the subsidies to a single moment or year."[291]

41. In other words, consistent with Article 14 of the SCM Agreement, the identified subsidy "benefit" is measured as of the time that the government bestowed the subsidy, and the amount thereby measured is fixed for purposes of applying USDOC's normal allocation methodology. It is this fixed amount which is then allocated over time in accordance with USDOC's normal allocation methodology. As USDOC explained, a subsequent event, such as the sale of a company, *per se*, does not and cannot eliminate this potential countervailability because the US countervailing duty statute does not permit the amount of the subsidy "benefit" to be re-evaluated based upon the use or effect of the subsidy.[292]

42. In the General Issues Appendix, USDOC gave two examples to help explain this conclusion. First, it stated that

> if a government were to provide a specific producer with a smokestack scrubber in order to reduce air pollution, the Department would countervail the amount that the company would have had to pay for the scrubber on the market, notwithstanding that the scrubber may actually reduce the company's output or raise its cost of production.[293]

USDOC further stated:

> Similarly, the Department does not take account of subsequent developments that may reduce any initial cost savings or increase in output from a subsidy. For instance, if a government provides a piece of capital equipment to a company, the Department continues

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> 'subsidy' under prior versions of the statute, unless that practice or interpretation is inconsistent with the definition contained in the bill. Absent such inconsistency, ... practices countervailable under the current law will be countervailable under the revised statute.

SAA at 255 (emphasis added) (attached as Ex. USA-12). In its subsequent analysis of the elements of a "subsidy," the SAA does not identify any instances in which prior US practice is inconsistent with the "benefit" requirement. It simply says that the statute "reflects the 'benefit-to-the-recipient' standard which long has been a fundamental basis for identifying ... subsidies under US CVD practice." Ibid. at 257. *Accord*, *1994 Review*, 61 Fed. Reg. at 58378-79.

[289] *See Delverde, SrL v. United States*, 24 F. Supp. 2d 314 (CIT 1998) ("*Delverde*") (Ex. USA-13).

[290] General Issues Appendix, 58 Fed. Reg. at 37260.

[291] Ibid. at 37261.

[292] Ibid. at 37263.

[293] Ibid. at 37261.

> to countervail the value of that equipment as received, regardless of whether it subsequently becomes obsolete or is taken out of production.[294]

43. Proceeding to the argument that the sale of a company automatically extinguishes prior subsidies because "the fair market price must include any remaining economic benefit from the subsidies,"[295] which is the argument on which the EC's challenges are based, USDOC carefully and thoroughly considered it and then expressly rejected it. USDOC noted that this argument rests on the assumption that subsidies must confer a demonstrated *continuing* benefit on production in order to be countervailable.[296] This assumption was contrary to the US countervailing duty statute, according to USDOC, just as it is contrary to the SCM Agreement. As USDOC explained, the US countervailing duty statute contains "the irrebuttable presumption that nonrecurring subsidies benefit merchandise produced by the recipient over time," without requiring any re-evaluation of those subsidies based on the use or effect of those subsidies or subsequent events in the marketplace.[297]

44. The "irrebuttable presumption" concept, as used in this context, is simply a reference to USDOC's normal allocation methodology. Under that methodology, which applies to so-called "non-recurring" subsidies,[298] USDOC allocates the measured subsidy benefit over time, i.e., to future production, pursuant to a standard declining balance formula that generates a net present value equal to the amount of the subsidy. The period of time selected for this allocation is based on the subsidy recipient's average useful life of assets. For example, in the administrative reviews at issue, USDOC would have allocated - or, essentially, amortized - a £100 million grant over an 18-year period running from the bestowal of the grant, with the following amounts allocated to each of the 18 years:[299]

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[294] General Issues Appendix, 58 Fed. Reg. at 37261 (citation omitted).
[295] Ibid. at 37263.
[296] Ibid. at 37263.
[297] Ibid. at 37263.
[298] The subsidies at issue in this dispute were quite large and were provided on an irregular basis and/or required prior government approval for their disbursement. USDOC's practice is to allocate these types of subsidies - known as "non-recurring" subsidies - over time. General Issues Appendix, 58 Fed. Reg. at 37226. USDOC expenses certain other types of subsidies - known as "recurring" subsidies - in the year of receipt, i.e., subsidies that are provided on a regular basis and that are automatic, in that each subsidy is not conditioned on prior government approval. Ibid.
[299] For administrative ease, the United States has used a discount rate of 10 per cent in this example.

Year	Benefit
1	15,555,600
2	15,000,000
3	14,444,500
4	13,888,900
5	13,333,300
6	12,777,800
7	12,222,200
8	11,666,700
9	11,111,100
10	10,555,600
11	10,000,000
12	9,444,500
13	8,888,900
14	8,333,300
15	7,777,800
16	7,222,200
17	6,666,700
18	6,111,100

Essentially, by allocating the measured subsidy benefit over time, USDOC is irrebuttably presuming that non-recurring subsidies benefit production over time. This means that USDOC does not undertake an inquiry into whether and, if so, to what extent the subsidy continues to benefit production at any subsequent point in time. Rather, USDOC simply will countervail the amount of the subsidy originally allocated to the year that is the POR. In the above example, if year 10 were the POR, USDOC would countervail a subsidy benefit equal to £10,555,600.

45. This type of allocation methodology is contemplated by the SCM Agreement,[300] and it is used in various forms by other WTO Members, including the EC.[301] It also has been endorsed by an Informal Group of Experts appointed by the Committee on Subsidies and Countervailing Measures.[302]

46. On the basis of these principles, USDOC affirmatively adopted the approach of treating non-recurring subsidies previously provided to the seller as potentially allocable to the production transferred to the purchaser in a privatization or other change-in-ownership transaction, such as when a government-owned company sells one of its productive units. At the same time, however, USDOC needed to resolve the issue of whether, or under what circumstances, to allocate

[300] *See, e.g.*, SCM Agreement, Annex IV, para. 7.

[301] *See, e.g.*, Guidelines for the Calculation of the Amount of Subsidy in Countervailing Duty Investigations, published in the Official Journal of the European Communities at OJ C 394, 17.12.98, and notified to the Committee on Subsidies and Countervailing Measures in document G/SCM/N/1/EEC/2/Suppl.2 (8 January 1999) ("EC Countervailing Duty Regulations") (attached as Ex. USA-14).

[302] *See* G/SCM/W/415/Rev.2.

the prior subsidies to the seller, to the purchaser, or to both the seller and the purchaser.

47. Historically, USDOC addressed this allocation issue, in the first instance, in the privatization context, when it considered specifically whether some portion of the prior subsidies should be allocated to the seller (i.e., the government) and considered to be repayment of the prior subsidies. This particular inquiry was prompted by the fact that it has been USDOC's longstanding practice generally that subsidies can be extinguished by being repaid to the government.[303]

48. On this issue, as the General Issues Appendix reflects, some parties had argued that "privatization at fair market value necessarily constitutes repayment of the residual value of any remaining benefit."[304] Other parties had argued that privatization *per se* does not eliminate any of the prior subsidies. Still others had made an argument that fell in between these two positions, with their position being that some portion of the remaining value of the prior subsidies should be treated as offset by the purchase price paid by the new owner.[305] USDOC adopted this last approach, as it was consistent with its past practice. USDOC explained:

> As part of our administration of the law, we have determined that there must be an allowance for the repayment of prior subsidies. ... In the context of privatization, we have concluded that a payback to the government by the new company or its owners (which we regard essentially as one and the same in these circumstances), regardless of how it is patterned, can indeed repay at least some amount of the subsidies remaining..[306]

49. The problem that USDOC faced at this point was how to calculate the portion of the purchase price attributable to the repayment of prior subsidies. The most reasonable starting point in this analysis was to determine the percentage of the company's value attributable to prior subsidies. Unfortunately, there is no economic analysis available that can identify the percentage of a company's value attributable to prior subsidies.[307] Certainly, however, given that the purchaser was paying for the entire company, at least some portion of the company's value, however large or small, realistically could be attributable to prior subsidies.

50. Absent guidance in the US countervailing duty statute (or the GATT Subsidies Code, which was then in force), USDOC resolved this problem by developing a calculation which yields a reasonable estimate of the percentage of the

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[303] *See* General Issues Appendix, 58 Fed. Reg. at 37261.

[304] *See* General Issues Appendix, 58 Fed. Reg. at 37261.USDOC rejected this argument, as it again was premised on an assessment of the value of the prior subsidies - or, in other words, the continuing "competitive benefit" from the prior subsidies - as of the time of the privatization transaction. Ibid.

[305] *See* General Issues Appendix, 58 Fed. Reg. at 37261.

[306] *See* General Issues Appendix, 58 Fed. Reg. at 37264 (citation omitted).

[307] Arguably, an extensive econometric analysis could accomplish this task. However, at best, it would be administratively infeasible to undertake this type of analysis in a countervailing duty proceeding, given the tight time deadlines appearing in Articles 11.11 and 21.4 of the SCM Agreement. At worst, it would be an expensive, resource-intensive exercise that would still be subjective and not necessarily any more accurate

company's value attributable to prior subsidies. In the context of a privatization, this calculation essentially divides the amount of non-recurring subsidies[308] received by the company prior to privatization by the company's net worth over time in order to obtain the percentage of the company's value reasonably attributable to prior subsidies. USDOC then multiplies this percentage by the purchase price to obtain the amount of the purchase price representing the portion of prior subsidies allocable to the seller. In other words, if the ratio of non-recurring subsidies to net worth is 75 per cent, USDOC will allocate subsidies totalling 75 per cent of the purchase price to the seller. Because the seller is the government, this allocated amount is considered to be repaid to the government and, therefore, extinguished. The remainder of the prior subsidies, meanwhile, is allocable to the production transferred to the purchaser and remains countervailable.

51. It bears noting that the universe of subsidy funds that can be allocated between the seller and the purchaser under USDOC's change-in-ownership methodology is not in any way based upon a re-valuing of prior subsidies. Rather, the universe of subsidy funds equals the same amount of prior subsidies already allocated to the POR under USDOC's normal methodology for allocating non-recurring subsidies over time. USDOC's change-in-ownership methodology further apportions that amount between the seller and the purchaser.

52. When USDOC first adopted this approach, it explained:

> The estimate so obtained of the proportion of prior subsidies repaid through privatization is the most reasonable that we have been able to devise. Although the "all-or-nothing" alternatives proposed by respondents and petitioners avoid difficult allocation problems inherent in the Department's approach, they are dependent on assumptions which we believe are incorrect.[309]

53. The methodology developed by USDOC theoretically can result in the full pass through of benefits from prior subsidies, or absolutely no pass through of benefits, or anything in between, depending on the facts of a particular case. This aspect of USDOC's methodology was noted and endorsed by the US Court of Appeals for the Federal Circuit when it stated: "Commerce's methodology correctly recognizes that a number of scenarios are possible: the purchase price paid by the new private company might reflect partial repayment of the subsidies, or it might not."[310]

54. When this approach is applied to a spin-off rather than a full privatization, such as the transaction creating the UES joint venture, there is no "extinguishment" of prior subsidies. Instead, the full amount of the prior subsidies allocated between seller and purchaser remains countervailable, although what actually will be countervailed in a particular case depends on whether the seller or the pur-

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[308] USDOC's change-in-ownership methodology only applies to non-recurring subsidies, which, as is explained in note 22 above, are allocated over time. It does not apply to recurring subsidies because they are expensed in the year of receipt.

[309] Ibid. at 37263.

[310] *Saarstahl AG v. United States*, 78 F.3d 1539, 1544 (Fed. Cir. 1996) ("*Saarstahl II*") (attached as Ex. USA-15).

chaser, or both, are under investigation. For example, if USDOC investigates subsidies benefiting a government-owned company - the seller - which has spun off a productive unit, USDOC will countervail, *inter alia*, the portion of the prior subsidies which has been allocated to the seller pursuant to the formulas which it has developed.[311] Or, if USDOC is investigating the purchaser of the productive unit, it will countervail the portion of the prior subsidies allocated to the purchaser, as it did, in effect, with regard to the UES joint venture transaction in the three challenged administrative reviews.

55. USDOC's methodology applies regardless of how high or how low the purchase price might be. USDOC's methodology is designed to use whatever the purchase price turns out to be. The amount of the purchase price simply affects the allocation of subsidies between seller and purchaser. Consequently, it is not relevant, from a methodological standpoint, whether the purchase price is at fair market value or above or below fair market value.[312]

56. To date, the US courts have upheld USDOC's methodology under pre-Uruguay Round law, both in the context of privatization, where USDOC found repayment to the government,[313] and in the context of spin-offs, where USDOC allocated subsidy amounts to the seller and the purchaser, without any repayment to the government.[314] These holdings also have been extended by the US courts to post-Uruguay Round law.[315]

57. The US courts have expressly rejected the argument, put forth by the EC here, that "the arm's length sale of a [government-owned] company extinguished any remaining 'competitive benefit' from the prior subsidies, because the price presumably included the market value of any continuing competitive benefit."[316] The courts have explained that this argument is based on a faulty premise, namely, that "subsidies may not be countervailed unless they confer a demonstra-

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[311] *See* General Issues Appendix, 58 Fed. Reg. at 37269 (in Swedish and UK steel investigations, *Final Affirmative Countervailing Duty Determinations; Certain Steel Products from Sweden*, 58 Fed. Reg. 37385 (9 July 1993) (attached as Ex. USA-16), and *Final Affirmative Countervailing Duty Determination; Certain Steel Products from the United Kingdom*, 58 Fed. Reg. 37393 (9 July 1993) ("*UK Steel Final Determination*") (attached as Ex. USA-17), where the respondent was a government-owned company that had spun off a productive unit, USDOC allocated a portion of the prior subsidies to the spun-off productive unit and the remainder to the government-owned company and, then, countervailed the portion allocated to the government-owned company, the company that happened to be under investigation).

[312] As USDOC explained in the General Issues Appendix:

> Given the Department's methodology, petitioners' and respondents' concerns regarding whether or not the sale ... was at a fair market price are irrelevant. To the extent that the purchase price may have been lower than the offer made by a different bidder, correspondingly less of any pre-existing subsidies were repaid.

58 Fed. Reg. at 37264.

[313] *See British Steel plc v. United States*, 127 F.3d 1471 (Fed. Cir. 1997) ("*British Steel*") (attached as Ex. USA-18); *Saarstahl II, supra*.

[314] *See Inland Steel Bar Co. v. United States*, 86 F.3d 1174 (Fed. Cir. 1996) (per curiam) (citing *Saarstahl II* rationale) (attached as Ex. USA-19).

[315] *See Delverde, supra*.

[316] *Saarstahl II*, 78 F.3d at 1541 (citing *Saarstahl AG v. United States*, 858 F. Supp. 187, 193 (CIT 1994)).

ble competitive benefit upon the merchandise exported to the United States."[317] The courts rejected any notion that it was proper for USDOC to re-evaluate subsidy benefits based on the use or effect of the subsidies. As one court stated,

> the statute makes clear that Congress did not require Commerce to determine the effect of the subsidy once bestowed. Indeed, Congress has expressed the contrary view that "an 'effects' test for subsidies has never been mandated by the law and is inconsistent with effective enforcement." North American Free Trade Agreement Implementation Act, S. Rep. No. 189, 103d Cong., 1st Sess. 42 (1993). It would be "burdensome and unproductive for the Department of Commerce to attempt to trace the use and effect of a subsidy demonstrated to have been provided to producers of the subject merchandise." Id. at 42-43.[318]

Consequently, according to the US courts, an arm's length transaction, at fair market value, does not automatically extinguish previously bestowed subsidies because the US countervailing duty statute does not make the existence of a continuing "competitive benefit" a condition of countervailability.[319]

58. The US courts have identified what is necessary in order for USDOC to impose countervailing duties on a company after its ownership has changed hands. According to the US courts, USDOC is authorized to impose duties on the showing that two statutory requirements are satisfied: "(1) a subsidy is provided with respect to the manufacture, production, or sale of a class or kind of merchandise; and (2) a domestic industry is injured by reason of imports into the United States of that class or kind of merchandise."[320] In other words, with regard to the "subsidy" requirement, it is only necessary for the investigating authority to establish that a subsidy was bestowed on the company's production prior to the change in ownership, i.e., that there was a "financial contribution" which thereby conferred a "benefit." There is no *requirement* to identify a continuing "competitive benefit" after ownership of the company changes hands.[321]

59. Even though several of the relevant US court decisions construed the pre-Uruguay Round countervailing duty statute, those decisions continue to be applicable under the post-Uruguay Round statute. None of the provisions added to the US statute to reflect the Uruguay Round's SCM Agreement altered the principles on which USDOC's original methodology was based.[322]

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[317] *Saarstahl II*, 78 F.3d at 1543 (citing *Saarstahl AG v. United States*, 858 F. Supp. 187, 193 (CIT 1994)).
[318] Ibid.
[319] Ibid.
[320] Ibid. (citing 19 U.S.C. § 1671(a)).
[321] Ibid.
[322] *See Delverde*, 24 F. Supp. 2d at 315-17. *Accord*, *Delverde Remand Determination* at 26-34, 34-35. One provision in the post-Uruguay Round statute specifically addressed changes in ownership. That provision, Section 771(5)(F), states:

> A change in ownership of all or part of a foreign enterprise or the productive assets of a foreign enterprise does not by itself require a determination by the administering authority that a past countervailable subsidy received by the enterprise no

60. Recognizing this fact, the one US court to have addressed the issue has held that USDOC's methodology is consistent with the post-Uruguay Round statute.[323]

61. Although the US court decisions discussed above are in no way binding on a WTO panel, they may be useful to the Panel to consider, given that they represent an independent interpretation of a countervailing duty law that is indistinguishable from the SCM Agreement in the areas relevant to this matter.[324]

62. Indeed, a review of the negotiating history of the SCM Agreement shows that the United States promoted language regarding the subsidy "benefit" which reflected USDOC's pre-Uruguay Round practice. It was substantially identical language that was adopted and now appears in the SCM Agreement as well as in the post-Uruguay Round US countervailing duty statute.[325]

B. The Changes in Ownership

63. Below, the United States sets forth the basic facts surrounding the three changes in ownership which are the subject of the EC's challenges, i.e., the 1986 transaction spinning off a major portion of BSC's Special Steels Business to the UES joint venture, the 1988 transaction in which BSC was privatized, and the 1995 transaction in which the privatized BSC, known as BS plc, re-acquired full ownership of the UES joint venture.

1. The 1986 Spin-off Creating the UES Joint Venture

64. In 1986, government-owned BSC and a private company, Guest, Keen & Nettlefolds ("GKN"), entered into an arm's length transaction and formed a joint venture company, to be known as United Engineering Steels or UES. In return for shares in UES, BSC contributed lead bar-producing assets from its Special Steels Business, along with certain other assets. Similarly, GKN contributed various steel facilities and other assets in return for UES shares.[326]

> longer continues to be countervailable, even if the change in ownership is accomplished through an arm's length transaction.

Section 771(5)(F), like the SCM Agreement, does not dictate any particular approach that USDOC must follow in addressing a change in ownership. It only acts to preserve the ability of USDOC to exercise its discretion. The US Congress enacted this provision in order to overturn the precedent (temporarily) established by a lower court decision construing pre-Uruguay Round US countervailing duty law, in which the lower court had mandated that USDOC find that an arm's length transaction, in and of itself, precludes any pass-through of subsidies to the purchaser. (It was this lower court decision that was overturned on appeal in *Saarstahl II*.) *See id.* at 53.

[323] *See Delverde, supra*.

[324] *See* note 12 *supra*.

[325] *See* MTN.GNG/NG10/W/29 at 6 (22 November 1989) (attached as Ex. USA-20) (discussed in 1 The GATT Uruguay Round: A Negotiating History (1986-1992) at 861, 892 (1993) (attached as Ex. USA-21)).

[326] *See 1996 Review*, 63 Fed. Reg. at 18368; *1995 Review*, 62 Fed. Reg. at 53308-09; *1994 Review*, 61 Fed. Reg. at 58378; *Remand Determination* at 7; *Final Determination*, 58 Fed. Reg. at 6238, 6240.

65. USDOC treated this transaction as a change in ownership for various reasons. For one thing, BSC did not retain a controlling interest in the UES joint venture; both BSC and GKN held 50 per cent of the voting shares. In addition, various circumstances surrounding the management and operation of the joint venture indicated that BSC did not dominate GKN. Rather, the UES joint venture was an independent corporate entity.[327]

66. Following this transaction, BSC itself no longer produced the subject merchandise. Only the UES joint venture produced it.[328]

2. The 1988 Privatization of BSC

67. The next change-in-ownership transaction took place two years later in 1988. At that time, the UK Government fully privatized BSC at a price of £2.5 billion, with the privatized company being known as BS plc.[329]

68. Following this transaction, as before, the independent UES joint venture continued to produce the subject merchandise. BS plc did not produce the subject merchandise until it re-acquired the UES joint venture in 1995.

3. The 1995 Re-acquisition of the UES Joint Venture

69. The last relevant change in ownership took place in 1995. At that time, the privatized company, BS plc, acquired full ownership of the UES joint venture. Until then, BS plc had only held a partial ownership interest in the UES joint venture (which it had assumed when BSC was privatized into BS plc in 1988). Thus, the UES joint venture became a wholly owned subsidiary of BS plc, and it was re-named British Steel Engineering Steels ("BSES").[330]

70. Following this transaction, the producer of the subject merchandise was BS plc, through BSES, now a wholly owned subsidiary of BS plc.

C. USDOC's Determinations in the 1994, 1995 and 1996 Reviews

71. In the administrative reviews at issue, USDOC followed the general approach contemplated by the SCM Agreement for deriving the subsidy amount allocable to the POR out of the more than *seven billion pounds* of UK Government subsidies that had been bestowed on BSC.[331] Thus, USDOC first *identified* the existence of potentially countervailable subsidies in accordance with Article

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[327] *See Remand Determination* at 7; *Final Determination*, 58 Fed. Reg. at 6240.
[328] *See 1994 Review*, 61 Fed. Reg. at 58378, 58383; *Final Determination*, 58 Fed. Reg. at 6240.
[329] *See 1996 Review*, 63 Fed. Reg. at 18368; *1995 Review*, 62 Fed. Reg. at 53307.
[330] *See 1996 Review*, 63 Fed. Reg. at 18368-69; *1995 Review*, 62 Fed. Reg. at 53307-08.
[331] USDOC's practice is to calculate the per-unit subsidy rate essentially by dividing the amount of the subsidy by the subsidized firm's sales. Specifically, in the numerator of this calculation, USDOC places the total amount of the subsidy allocable to the POR. In the denominator, USDOC places the appropriate portion of the firm's sales. In order to determine the appropriate sales to place in the denominator, USDOC undertakes its so-called "tying" analysis. For example, a subsidy may be "tied" to a particular product; in that event, USDOC would place only sales of that product in the denominator. If a subsidy is "untied," USDOC would place the firm's total sales in the denominator.

1. Next, USDOC *measured* the subsidy amounts consistent with the guidelines set forth in Article 14. Then, USDOC *allocated* those subsidy amounts over a period of years.

72. USDOC *identified* the existence of countervailable subsidies by looking only at the circumstances as they existed when the UK Government provided the subsidies at issue. USDOC began this task by referring to the investigation segment of the proceeding and noting that it had previously determined - meaning in the original lead bar investigation - that subsidies under three programmes had been bestowed. The three programmes were (a) Equity Infusions, (b) Regional Development Grant Programme, and (c) National Loan Fund (or NLF) Loan Cancellation.[332] USDOC also noted that a fourth subsidy programme, i.e., ECSC Article 54 Loans and Interest Rebates[333], had been identified in the investigation of *Certain Steel Products from the United Kingdom*,[334] which had taken place shortly after the lead bar investigation. USDOC then found that no new information had been presented in the 1994, 1995 and 1996 reviews - again, with regard to the events at the time of the subsidy bestowals - and, accordingly, did not change the determinations in the original lead bar and steel investigations that countervailable subsidies had been bestowed.

73. As the record evidence showed, all of the subsidies provided to BSC under these four programmes pre-dated the first change-in-ownership transaction, which was the spin-off of the UES joint venture from BSC in 1986.

74. Pursuant to Section 18(1) of the Iron and Steel Acts of 1975, 1981 and 1982, the UK Government, through the Secretary for Trade and Industry, provided "financial contributions" within the meaning of Article 1.1(a) by making equity infusions into BSC. The UK Government made these infusions in every fiscal year from 1977-78 through 1985-86. USDOC found each of the infusions to confer a "benefit" within the meaning of Article 1.1(b) because they were inconsistent with commercial considerations, i.e., they were inconsistent with the usual investment practice of private investors, as of the time of each of the infusions. USDOC also found that the infusions were "specific" within the meaning of Articles 1.2 and 2 because BSC was the sole recipient of infusions under this programme.[335]

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[332] *See 1996 Review*, 63 Fed. Reg. at 18369-70; *Preliminary Results of Administrative Review; Certain Hot-rolled Lead and Bismuth Carbon Steel Products from the United Kingdom*, 62 Fed. Reg. 64568, 64570-71 (8 December 1997) ("*1996 Preliminary Results*") (attached as Ex. USA-22); *1995 Review*, 62 Fed. Reg. at 53308; *Preliminary Results of Administrative Review; Certain Hot-rolled Lead and Bismuth Carbon Steel Products from the United Kingdom*, 62 Fed. Reg. 16555, 16558-59 (7 April 1997) ("*1995 Preliminary Results*") (attached as Ex. USA-23); *1994 Review*, 61 Fed. Reg. at 58378; *Preliminary Results of Administrative Review; Certain Hot-rolled Lead and Bismuth Carbon Steel Products from the United Kingdom*, 61 Fed. Reg. 20238, 20239-41 (6 May 1996) ("*1994 Preliminary Results*") (attached as Ex. USA-24).

[333] *1995 Review*, 62 Fed. Reg. at 53308; *1995 Preliminary Results*, 62 Fed. Reg. at 16559; *1994 Review*, 61 Fed. Reg. at 58378; *1994 Preliminary Results*, 61 Fed. Reg. at 20241.

[334] *See UK Steel Final Determination*, 58 Fed. Reg. at 37397.

[335] *1996 Preliminary Results*, 62 Fed. Reg. at 64570;*1995 Preliminary Results*, 62 Fed. Reg. at 16558; *1994 Preliminary Results*, 61 Fed. Reg. at 20239. *See Final Determination*, 58 Fed. Reg. at 6242.

75. BSC received financial contributions in the form of outright grants under the Regional Development Grant Programme between fiscal years 1977-78 and 1984-85. USDOC identified the benefit here simply as the amount of the grant, and it found the grants to be regionally specific.[336]

76. The UK Government also made financial contributions by cancelling BSC's NLF loans, together with accrued interest thereon, at the end of BSC's 1980-81 fiscal year as part of a capital reconstruction of BSC. USDOC treated these loan cancellations as equivalent to grants, and therefore the benefit was the amount of the forgiven principal and interest. These loan cancellations were specific because the UK Government only cancelled loans to BSC.[337]

77. The EC provided financial contributions to BSC in the form of two ECSC Article 54 loans in 1977, along with a series of interest rebates. USDOC found a benefit from the loans because the terms of the loans were inconsistent with commercial considerations. Specifically, after accounting for the interest rebates, the interest rates on the loans were lower than the benchmark interest rate prevailing in 1977 for uncreditworthy[338] companies like BSC. USDOC treated these loans as specific because the EC only provided them to the coal and steel industries.[339]

78. None of these findings are challenged by the EC in this dispute.

79. Next, USDOC *measured* the benefits from these subsidies.

80. For the UK Government equity infusions, USDOC looked to the usual investment practice of private investors as of the time of each of the infusions, just as it did when identifying the benefit of the infusions. USDOC found that a reasonable private investor would not have made the infusions which the UK Government made, given that BSC was unequityworthy[340] when it received each

[336] *1996 Preliminary Results*, 62 Fed. Reg. at 64570;*1995 Preliminary Results*, 62 Fed. Reg. at 16558-59; *1994 Preliminary Results*, 61 Fed. Reg. at 20241. *See Final Determination*, 58 Fed. Reg. at 6242.

[337] *1996 Preliminary Results*, 62 Fed. Reg. at 64570-71;*1995 Preliminary Results*, 62 Fed. Reg. at 16559; *1994 Preliminary Results*, 61 Fed. Reg. at 20241. *See Final Determination*, 58 Fed. Reg. at 6242.

[338] Under USDOC's practice, a company is generally considered "uncreditworthy" if the information available at the time that the terms of the government's loan were agreed upon indicated that the recipient company could not have obtained long-term financing from conventional commercial sources. USDOC generally will select a higher benchmark interest rate, for use in assessing whether the government loan at issue confers a benefit, when the recipient company is uncreditworthy as opposed to creditworthy.

[339] *1995 Preliminary Results*, 62 Fed. Reg. at 16559; *1994 Preliminary Results*, 61 Fed. Reg. at 20241. *See UK Steel Final Determination*, 58 Fed. Reg. at 37397.

[340] When, as here, a market price for the shares purchased by the government was not available, USDOC conducts a test to determine whether the company at issue was "equityworthy" at the time that the government purchased the shares. Under this test, if the company were deemed equityworthy, i.e., it appeared capable of generating a reasonable rate of return within a reasonable period of time, the government infusion of equity through the purchase of the shares would not confer a benefit. A finding that the company was unequityworthy would mean that the government's investment was inconsistent with the usual investment practice of private investors, and USDOC would find a benefit conferred.

of the infusions. USDOC therefore treated the infusions as equivalent to outright grants and measured the benefit as the entire amount of the infusions.[341]

81. USDOC measured the benefits from the grants under the Regional Development Grant Programme simply by using the face amounts of the grants.[342]

82. With regard to the NLF loan cancellations, USDOC treated them as grant equivalents and measured the benefits as the face amounts of the principal and interest that had been cancelled.[343]

83. USDOC measured the benefits from the ECSC Article 54 loans and interest rebates as the difference between the actual, effective interest rates on the loans and the benchmark interest rate prevailing in 1977 for uncreditworthy companies like BSC.[344]

84. Again, none of these findings are challenged by the EC in this dispute.

85. The next step under USDOC's practice was to *allocate* the benefits from these various subsidies over time,[345] i.e., to future production.[346] Here, USDOC applied its standard allocation methodology, which, under the facts in the record, required allocating the benefits from each subsidy over an 18-year period, measured from the year of the subsidy's bestowal.[347] This allocation created a separate 18-year benefit stream for each subsidy, with the appropriate portions of the subsidy benefit being allocated to each of the 18 years pursuant to a standard declining balance formula. Generally, the amount allocated to the year that is the POR is what USDOC will allocate to exports of the subject merchandise and will countervail in the POR.

86. Again, the EC does not challenge how USDOC applied its normal allocation methodology to the record facts.

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[341] *1996 Preliminary Results*, 62 Fed. Reg. at 64570;*1995 Preliminary Results*, 62 Fed. Reg. at 16558; *1994 Preliminary Results*, 61 Fed. Reg. at 20239. *See Final Determination*, 58 Fed. Reg. at 6242.

[342] *1996 Preliminary Results*, 62 Fed. Reg. at 64570;*1995 Preliminary Results*, 62 Fed. Reg. at 16558-59; *1994 Preliminary Results*, 61 Fed. Reg. at 20241. *See Final Determination*, 58 Fed. Reg. at 6242.

[343] *1996 Preliminary Results*, 62 Fed. Reg. at 64570-71;*1995 Preliminary Results*, 62 Fed. Reg. at 16559; *1994 Preliminary Results*, 61 Fed. Reg. at 20241. *See Final Determination*, 58 Fed. Reg. at 6242.

[344] *1995 Preliminary Results*, 62 Fed. Reg. at 16559; *1994 Preliminary Results*, 61 Fed. Reg. at 20241. *See UK Steel Final Determination*, 58 Fed. Reg. at 37397.

[345] *See* Part III.A., paras. 43-45 *supra*.

[346] As a preliminary matter, USDOC had first recognized that all of the subsidies at issue were for the benefit of BSC's entire UK operations. As the EC concedes, the subsidies received by BSC were not restricted to particular UK units of BSC, but rather benefited and therefore were attributable to BSC's entire UK operations. Consequently, USDOC's allocation analysis focused on the future production of BSC's entire UK operations rather than some subset thereof.

[347] In the final determination and the 1994 review, USDOC applied a 15-year allocation period. *See Final Determination*, 58 Fed. Reg. at 6245. Beginning with the 1995 review, USDOC revised the allocation period upward to 18 years because of decisions of the US Court of International Trade in the litigation arising out of the *UK Steel* final determination, which required USDOC to base the allocation period on the average useful life of assets for BSC, as calculated from BSC's financial statements. *See 1995 Review*, 62 Fed. Reg. at 53315-16.

87. In its final step, USDOC accounted for the changes in ownership at the core of this dispute. Here, USDOC applied a second allocation methodology, i.e., its change-in-ownership methodology, described above in Part III.A. Because the subsidies at issue had already been identified and measured, USDOC did not inquire into whether the subsidies at issue continued to exist, and it did not attempt to re-value any of the subsidies. Instead, for each subsidy, USDOC essentially took the amount already allocated to each year of the 18-year allocation period falling after the change in ownership and further apportioned that amount between the seller and the purchaser. This computation did not reduce the aggregate amount already allocated to any given year; rather, the total of the amount allocated to the seller and the amount allocated to the purchaser in a given year equalled the aggregate amount already allocated to that year. The amount actually countervailed in the POR could only be considered reduced as a result of the change in ownership in the sense that the amount apportioned to the purchaser and therefore countervailed was less than the aggregate amount already allocated to the POR.

88. For the 1994 POR, when the UES joint venture was the sole producer of the subject merchandise, the only relevant change in ownership was the 1986 spin-off of lead bar-producing assets of BSC's Special Steels Business to the UES joint venture.[348] USDOC therefore only addressed the UES joint venture and, specifically, what subsidies could be attributed to the UES joint venture following its 1986 spin-off from BSC under USDOC's change-in-ownership methodology.

89. USDOC began its analysis of the spin-off by establishing the pro rata share of the massive subsidies previously bestowed on BSC that were attributable to BSC's Special Steels Business, as opposed to other BSC operations, prior to the spin-off. Then, USDOC applied its change-in-ownership methodology and allocated a portion of the subsidies attributable to the Special Steels Business (57 per cent of them) to the UES joint venture, while the remaining portion of these subsidies (43 per cent) was allocated to BSC. USDOC arrived at its allocation between seller (BSC) and purchaser (the UES joint venture) pursuant to the calculation described in the General Issues Appendix.[349]

90. Overall, in the 1994 review, USDOC countervailed only the portion of the prior subsidies allocated to the UES joint venture through USDOC's change-in-ownership methodology.

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[348] USDOC had no reason to address the 1988 privatization of BSC, given that BSC at the time of that transaction and through the 1994 POR did not produce the subject merchandise. Any subsidization of BSC or its successor, BS plc, from the time of the 1986 spin-off of the UES joint venture through the 1994 POR had no impact on how the UES joint venture - the entity producing the subject merchandise in 1994 - was benefiting from prior subsidies. BS plc's 1995 re-acquisition of the UES joint venture was also not relevant, given that this transaction took place after the 1994 POR.

[349] *1994 Review*, 61 Fed. Reg. at 58378; *1994 Preliminary Results*, 61 Fed. Reg. at 20239-41. *See Remand Determination* at 2-4.

91. USDOC ultimately set duties on the UES joint venture's lead bar imports at the rate of 1.69 per cent *ad valorem* for the 1994 review.[350]

92. The 1995 review was divided into two parts, as the UES joint venture continued to be the sole producer of the subject merchandise for the first half of 1995, and then BS plc became the sole producer of the subject merchandise for the remainder of 1995 after it re-acquired the UES joint venture.

93. For the first part of the 1995 POR, USDOC countervailed the portion of the prior subsidies allocated to the UES joint venture as a result of the 1986 spin-off, just as it had in the 1994 review.

94. Then, in addressing the remainder of the 1995 POR, when BS plc was the sole producer of the subject merchandise, USDOC examined all three of the changes in ownership at issue.

95. First, USDOC handled the 1986 spin-off of the UES joint venture, just as it did in the 1994 review and the first part of the 1995 review, and allocated a portion of the prior subsidies to the UES joint venture. Second, setting aside those allocated subsidies, USDOC turned to the 1988 privatization of BSC and applied basically the same methodology that it had used for the 1986 spin-off of the UES joint venture. Here, USDOC was working with all of the subsidies previously bestowed on BSC, with the exception of the subsidy amounts earlier allocated to the UES joint venture. In other words, it was working with the 43 per cent of the prior subsidies that had been allocated to BSC (as explained in paragraph 89 above) in connection with the spin-off of the UES joint venture. Using the calculation that it had developed in the General Issues Appendix, USDOC allocated a portion of these subsidies (74 per cent of them) to the purchaser, BS plc, and it allocated the remaining portion of these subsidies (26 per cent) to BSC's seller, the UK Government. The portion allocated to the UK Government was considered to have been repaid to the government and therefore no longer subject to countervailing duties.[351] Third, turning to BS plc's 1995 re-acquisition of the UES joint venture, USDOC considered only the subsidies previously allocated to the UES joint venture after its creation in 1986, i.e., 57 per cent of the original BSC subsidies (as explained in paragraph 89 above). Following its change-in-ownership methodology, USDOC allocated a portion of these subsidies (92 per cent) to the purchaser, BS plc, and it allocated the remaining portion of these subsidies (8 per cent) to the sellers.[352]

96. Overall, for the last half of the 1995 POR, when BS plc was the sole producer of the subject merchandise, USDOC countervailed (a) the prior subsidies allocated to BS plc as a result of the 1988 privatization of BSC and (b) the portion of the prior subsidies allocated to the UES joint venture after its creation in 1986, minus that portion of those subsidies which was later allocated to GKN as a result of BS plc's 1995 re-acquisition of the UES joint venture.

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350 *1994 Review*, 61 Fed. Reg. at 58378, 58383.
351 Ibid. at 53308-09; *1995 Preliminary Results*, 62 Fed. Reg. at 16556-58.
352 Ibid.

97. Ultimately, for the 1995 review, USDOC set duties on the UES joint venture's lead bar imports at the rate of 2.40 per cent *ad valorem* and set duties on BS plc's lead bar imports at the rate of 7.35 per cent *ad valorem*.[353]

98. In the 1996 POR, BS plc continued to be the only producer of the subject merchandise. USDOC therefore followed the same approach that it had used for the last part of the 1995 POR.[354]

99. USDOC ultimately set duties on BS plc's lead bar imports at the rate of 5.28 per cent *ad valorem* for the 1996 review.[355]

IV. LEGAL ARGUMENT

100. The United States submits that the EC has failed to carry its burden of establishing that the United States violated Articles 1.1(b), 10, 14 or 19.4 of the SCM Agreement through USDOC's determinations in the 1994, 1995 and 1996 administrative reviews of the countervailing duty order on UK lead bar products.[356] In its First submission, the EC attempts to satisfy its burden essentially by advocating an approach to changes in ownership which, unlike USDOC's approach, focuses on whether a continuing "benefit" can be found to exist after the ownership of the subsidy recipient changes hands. However, the EC's approach, at best, is not required by the SCM Agreement and, at worst, conflicts with the basic framework of the SCM Agreement.

101. Below, the United States first discusses the appropriate standard of review for this Panel to apply. It then explains why USDOC's approach to changes in ownership is fully consistent with the SCM Agreement. Lastly, the United States addresses the legal infirmities and erroneous economic assumptions of the competing approach advocated by the EC.

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[353] *1995 Review*, 62 Fed. Reg. at 53308, 53317.

[354] Ibid. at 18368-69; *1996 Preliminary Results*, 62 Fed. Reg. at 64568-70.

[355] Ibid. at 18369, 18374.

[356] It is now well-established that the EC, as the complainant in this dispute, has the burden of establishing a violation of a provision of a WTO agreement. As the Appellate Body explained in *US – Wool Shirts and Blouses*, *supra*, footnote 284, at 335:

> [W]e find it difficult, indeed, to see how any system of judicial settlement could work if it incorporated the proposition that the mere assertion of a claim might amount to proof. It is, thus, hardly surprising that various international tribunals, including the International Court of Justice, have generally and consistently accepted and applied the rule that the party who asserts a fact, whether the claimant or the respondent, is responsible for providing proof thereof. Also, it is a generally-accepted canon of evidence in civil law, common law and, in fact, most jurisdictions, that the burden of proof rests upon the party, whether complaining or defending, who asserts the affirmative of a particular claim or defence.

(footnote omitted).

A. The Panel Should Apply a Standard of Review in this Dispute which Upholds the USDOC Determinations at Issue if they are Based on a Permissible Interpretation of the SCM Agreement

102. Article 17.6 of the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994, also known as the WTO Anti-Dumping Agreement, sets forth, in turn, the standards governing the panel's review of an investigating authorities' factual determinations and determinations interpreting WTO provisions. With regard to the latter type of determination, which is the only type of determination challenged by the EC in this dispute,[357] Article 17.6 provides:

> Where the panel finds that a relevant provision of the Agreement admits of more than one permissible interpretation, the panel shall find the [investigating] authorities' measure to be in conformity with the Agreement if it rests upon one of those permissible interpretations.

103. The Declaration on Dispute Settlement Pursuant to the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 or Part V of the Agreement on Subsidies and Countervailing Measures states "the need for consistent resolution of disputes arising from anti-dumping and countervailing duty measures".

104. The United States submits that the standard of review set forth in Article 17.6 of the Anti-Dumping Agreement should apply in the current dispute under the SCM Agreement. It is clearly what is contemplated by the above Declaration, and no sound reason exists for not applying it in disputes involving a Member's countervailing duty determinations, just as it is already applied with regard to a Member's anti-dumping determinations. In this regard, the Anti-Dumping Agreement and the SCM Agreement both address unfair trade, and one of the basic elements that must be established under both of the agreements - injury to the importing Member's domestic industry - is essentially the same.[358] In addition, the two agreements lay down similar procedural rules for a Member's investigating authority to follow during the course of an investigation, and they authorize similar remedies, i.e., the levying of duties or, alternatively, an undertaking.

105. Even if the Panel does not apply the Article 17.6 standard of review in this dispute, it should recognize the principle that the SCM Agreement, like many WTO agreements, leaves room for Members to develop and apply different methodologies and procedures when implementing the terms of the agreement.

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[357] To the extent that the Panel does conclude that factual determinations made by USDOC in the administrative reviews at issue are in dispute, the Panel should apply the standard of review for factual determinations set forth in Article 17.6.

[358] Under the Anti-Dumping Agreement, the two basic requirements that must be satisfied before duties may be imposed are (1) dumping and (2) injury, while the SCM Agreement requires (1) subsidization and (2) injury. Notably, the injury element under the Anti-Dumping Agreement is essentially the same as the injury element under the SCM Agreement.

This principle is particularly true where, as in this dispute, the agreement is silent regarding the methodology or procedure to be applied.

B. The USDOC Determinations at Issue are Fully Consistent with the SCM Agreement

106. The USDOC determinations at issue in this dispute are fully consistent with the United States' obligations under the SCM Agreement and, in particular, Articles 1.1, 10, 14 and 19.4.

107. Stated simply, the SCM Agreement is silent as to whether and, if so, how the investigating authority should take into account a change-in-ownership transaction in a countervailing duty proceeding. Consequently, USDOC acted permissibly when it addressed the massive BSC subsides as it did, given that its approach is grounded in fundamental SCM Agreement principles and is consistent with the object and purpose of the SCM Agreement. The Panel therefore should find that the United States has acted consistently with the SCM Agreement.

1. In Analysing the Subsidies at Issue, USDOC Strictly Adhered to all Relevant Provisions of the SCM Agreement

108. Below, the United States reviews, on a step-by-step basis, how USDOC analyzed the subsidies at issue, i.e., the subsidies bestowed on BSC's production prior to the changes in ownership at issue. This review shows that, at each step, USDOC strictly adhered to the SCM Agreement, to the extent that it provides direct guidance. In addition, where it does not provide direct guidance, USDOC used a permissible approach.

109. Thus, it will be seen that the SCM Agreement only directs (in Article 1) that the investigating authority *identify* the existence of a "subsidy," including a subsidy "benefit," as of the time of the subsidy bestowal and (in Article 14) that the investigating authority *measure* the identified subsidy "benefit" through certain market-rate benchmarks as of the time of the subsidy bestowal. In addition, the SCM Agreement contemplates that the measured subsidy "benefit" will be *allocated* over time, although it does not direct how this allocation must be done. Beyond that, however, the SCM Agreement is silent. It does not address a change in ownership, at least in the context of a countervailing duty proceeding. Specifically, it does not explain whether and, if so, how the investigating authority should take account of a change in ownership taking place after the subsidy bestowal.

110. In fact, the only place where the SCM Agreement addresses changes in ownership is in a provision dealing not with countervailing duty proceedings (under Part V of the SCM Agreement), but rather with WTO subsidy challenges under Part III of the SCM Agreement. That provision, Article 27.13, strongly implies a general rule that previously bestowed subsidies remain actionable and are allocable to the successor company's production following a change in ownership, which is consistent with USDOC's approach but exactly the opposite of the approach advocated by the EC. While Article 27.13 by its terms only applies

to WTO proceedings, it is difficult to find support, in these particular circumstances, for the notion that the SCM Agreement envisions one rule for WTO proceedings and another - contrary - rule for countervailing duty proceedings.

111. As is shown below, USDOC complied fully with each of the provisions of the SCM Agreement discussed above in addressing the subsidies at issue. In addition, in accounting for the changes in ownership that occurred after the subsidy bestowals, where no SCM Agreement provision directed a particular methodology, USDOC reasonably developed and applied a methodology based on fundamental principles underlying the SCM Agreement.

a) USDOC Followed Article 1.1 of the SCM Agreement, which only Requires the Investigating Authority to make a Finding of a Subsidy "Benefit" once as of the Time of the Subsidy Bestowal

112. The first step in USDOC's analysis was to determine whether the subsidies allegedly bestowed on BSC's production prior to the changes in ownership were potentially countervailable.

113. In this regard, the SCM Agreement imposes two basic requirements for a subsidy to be countervailable under the provisions of Part V. Article 1 requires a determination of the existence of a "subsidy" which is "specific" in nature, and Article 15 requires a determination of "injury."

114. In this dispute, the EC challenges how USDOC applied Article 1 and, in particular, paragraph 1(b) of Article 1, which addresses the "benefit" element of a "subsidy." It does not challenge the determination under Article 15.

115. Article 1.1 is brief and does not go into any relevant detail. According to Article 1.1, "a subsidy shall be deemed to exist" if (a) there is some type of "financial contribution" by the government,[359] and (b) "a benefit is thereby conferred."[360]

116. Article 1.1 does not address whether or, if so, how a change in ownership might affect the determination identifying the elements of a subsidy. It is silent on this issue.

117. Consequently, absent direct guidance in Article 1.1, USDOC set out to analyze the BSC subsidies at issue in a manner that was consistent with the basic principles of subsidy identification found in Article 1.1.

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[359] SCM Agreement, Art. 1.1(a)(1). Article 1.1(a)(1) describes various forms that a "financial contribution" can take. Although not relevant in this matter, a subsidy also can be deemed to exist if, instead of a "financial contribution," there is some form of income or price support in the sense of Article XVI of GATT 1994. Ibid., Art. 1.1(a)(2).

[360] Ibid., Art. 1.1(b). Article 1.2 provides that a subsidy satisfying this definition becomes potentially countervailable if it also is "specific" within the meaning of Article 2. Ibid., Art. 1.2.

118. Most importantly, the text of Article 1.1 (like its counterpart under the US countervailing duty statute)[361] reflects that the determination identifying the elements of a subsidy will be made once, as of the time of the subsidy bestowal. In this regard, the requisite "financial contribution" is described by Article 1.1(a) *in the present tense*, so that a "financial contribution" exists as soon as "there is" a direct transfer of funds,[362] or government revenue "is foregone,"[363] or the government "provides goods or services,"[364] or the government "makes payments to a funding mechanism."[365] The requisite "benefit" is also described *in the present tense*, as Article 1.1(b) provides that the requisite "benefit" arises if "a benefit is thereby conferred," i.e., conferred by the "financial contribution." The ordinary meaning arising from the use of the present tense to describe both elements is that Article 1.1 is concerned with, and requires the identification of, the "benefit" that is conferred at the time that the government provides the "financial contribution."

119. Nothing in the text of Article 1.1 suggests re-visiting the original determination identifying the elements of a subsidy as of the time of the subsidy bestowal. More particularly, nothing in the text of Article 1.1 suggests that it is necessary to inquire into whether there is any "benefit" from a subsidy continuing after the subsidy bestowal, as the EC argues.

120. Certainly, nothing in the text of Article 1.1 *requires* the investigating authority to make a new "benefit" determination simply because the ownership of the original subsidy recipient has changed hands.

121. Significantly, the context provided by Article 14, which addresses the measurement of the subsidy "benefit,"[366] supports this reading of Article 1.

122. Article 14 provides especially important context for interpreting how Article 1.1 contemplates that the "benefit" is to be identified. When the investigating authority uses the benefit-to-recipient measurement standard (as does USDOC), the act of identifying the "benefit" (under Article 1.1) is normally the same as the act of measuring the "benefit" (under Article 14).

123. The text of Article 14 (like its counterpart under the US countervailing duty statute)[367] is not comprehensive, in that it does not purport to explain how to measure the identified subsidy benefit in every possible situation. Instead, it se-

[361] Section 771(5)(B) of the US countervailing duty statute, 19 U.S.C. § 1677(5)(B), is the counterpart to Article 1.1. of the SCM Agreement.

[362] Section 771(5)(B) of the US countervailing duty statute, 19 U.S.C. § 1677(5)(B), is the counterpart to Article 1.1. of the SCM Agreement, Art. 1.1(a)(1)(i).

[363] Section 771(5)(B) of the US countervailing duty statute, 19 U.S.C. § 1677(5)(B), is the counterpart to Article 1.1. of the SCM Agreement, Art. 1.1(a)(1)(ii).

[364] Section 771(5)(B) of the US countervailing duty statute, 19 U.S.C. § 1677(5)(B), is the counterpart to Article 1.1. of the SCM Agreement, Art. 1.1(a)(1)(iii).

[365] Section 771(5)(B) of the US countervailing duty statute, 19 U.S.C. § 1677(5)(B), is the counterpart to Article 1.1. of the SCM Agreement, Art. 1.1(a)(1)(iv).

[366] Article 14 is the only provision of the SCM Agreement addressing how the investigating authority may measure the subsidy "benefit" identified pursuant to Article 1.1 in a countervailing duty proceeding.

[367] Section 771(5)(E) of the US countervailing duty statute, 19 U.S.C. § 1677(5)(E), is the counterpart to Article 14 of the SCM Agreement.

lects four common forms of subsidy and then describes how the investigating authority should measure the benefit for each of these forms of subsidy.

124. Like Article 1.1, Article 14 does not address whether or, if so, how a change in ownership might affect the measurement of the identified subsidy benefit. It is silent on this issue.

125. Nevertheless, in each of the four examples which it provides, Article 14 looks only to the time of the subsidy bestowal, and not to any subsequent point in time, for the measurement of the identified subsidy benefit.

126. Thus, Article 14(a) directs the investigating authority to examine the usual investment practice of private investors as of the time of the equity infusion at issue. Article 14(b) directs the investigating authority to examine the terms of a comparable commercial loan that the loan recipient could have obtained at the time the government loan at issue was made. Article 14(c) directs the investigating authority to examine what the loan recipient would have paid on a comparable commercial loan absent a government guarantee based on the terms and conditions prevailing at the time the government provided the guarantee. Article 14(d) directs the investigating authority to examine what would have been adequate remuneration at the time of the government's provision of the goods or services at issue.

127. If there is a general rule that can be derived from the text of Article 14, it is that the investigating authority should look to the time of the subsidy bestowal for the measurement of the subsidy benefit. The four examples take this approach, and there is nothing in the text of Article 14 that suggests that the investigating authority should measure - or re-measure - the subsidy benefit at any time after the subsidy bestowal.

128. Meanwhile, nothing in the text of Article 14 suggests ever re-visiting the measurement of the subsidy benefit made as of the time of the subsidy bestowal.

129. Certainly, nothing in the text of Article 14 *requires* the investigating authority to make a new measurement simply because the ownership of the original subsidy recipient has changed hands.

130. Thus, given that the act of identifying the "benefit" (under Article 1.1) is normally the same as the act of measuring the "benefit" (under Article 14), and given that Article 14 only contemplates a measurement of the "benefit" as of the time of the subsidy bestowal, Article 14 provides compelling contextual support for an interpretation of Article 1.1 as envisioning only that the investigating authority would identify the "benefit" as of the time of the subsidy bestowal.

131. The example of an unrelated trading company helps to clarify these principles. Here, assume that a heavily subsidized producer sells its products to an unrelated trading company in an arm's length transaction at fair market value, and then the trading company exports the same products. If Article 1.1 or any other provision of the SCM Agreement required the identification of a benefit *continuing* after the original subsidy bestowals, the subsidies previously bestowed on the producer would arguably have to be treated as eliminated because the trading company paid the market price for the products that it later exported. According to the EC's reasoning, there would be no benefit to the trading company from those subsidies and, consequently, there would be no subsidies to countervail in

the importing country. In this scenario, the result would be irrational, particularly because the competing industry in the importing country would have suffered the same injury regardless of whether the imports came from the trading company or the producer. The SCM Agreement avoids such irrational results by not requiring the identification of a *continuing* benefit.

132. For the same reasons, the SCM Agreement avoids such irrational results in the more fundamental example of an unrelated importer which purchases the subsidized product directly from the producer at an arm's length, fair market price. Indeed, if the SCM Agreement required the identification of a continuing benefit here, there would be no grounds for a Member to impose countervailing duties, given that, under the EC's reasoning, the producer by definition would not pass on its advantage to the unrelated importer.

133. Essentially, these examples reflect the fact that the SCM Agreement is a practical agreement, and it uses reasonable assumptions without which there would likely be no effective remedy for the trade distortions caused by subsidies. In particular, the SCM Agreement assumes that subsidies satisfying the requirements of Article 1.1 benefit the merchandise produced as a result of those subsidies, regardless of who owns the company or the productive assets used to produce the merchandise and regardless of who purchases the merchandise.

134. Turning to the USDOC determinations at issue, it is clear that USDOC fully complied with Article 1.1. As is shown in the Factual Background section above,[368] USDOC first looked at the circumstances as of the time of the alleged subsidy bestowals and identified the requisite "financial contributions" and "benefits" thereby conferred. It then found these subsidies to be "specific".

135. USDOC did not violate Article 1.1 by refusing to revisit its original determinations - and, in particular, by not attempting to re-identify the subsidy benefits - as of the time of the changes in ownership at issue. Article 1.1 simply does not *require* the investigating authority to revisit these determinations.

136. As we explain below in Part IV.C.1.a., the EC does not focus its contrary argument on the ordinary meaning of Article 1.1. Rather, it emphasizes what it views as the object and purpose of the SCM Agreement, and even then it misstates what that object and purpose is.

b) USDOC Followed Article 14 of the SCM Agreement, which Contemplates that the Investigating Authority will Measure the Subsidy "Benefit" once as of the Time of the Subsidy Bestowal

137. The next step in USDOC's analysis was to measure the subsidy benefits identified under Article 1.1.

[368] *See* Part III.C., paras. 72-78 *supra*.

138. As is shown in the Factual Background section above,[369] USDOC fully complied with Article 14 when it measured the benefits from the subsidies at issue, i.e., the equity infusions and grants. With regard to the equity infusions, USDOC followed Article 14(a) and examined the usual investment practice as of the time of the equity infusions in order to derive an appropriate measurement of their benefits. In addition, although Article 14 does not address grants, USDOC followed the general principles of Article 14 and looked only at the time of the subsidy bestowals to measure the grants' benefits.

139. USDOC did not violate Article 14 by failing to re-measure the identified subsidy benefits as of the time of the changes in ownership at issue. As is shown above in Part IV.B.1.a., there is nothing in Article 14 that *requires* the investigating authority to re-measure the identified subsidy benefit based upon any event occurring after the subsidy bestowal.

c) USDOC Acted Consistently with the SCM Agreement when it Applied its Normal Allocation Methodology and Allocated the Subsidies at Issue over Time

140. The next step required under USDOC's practice was to *allocate* the subsidies at issue over time, i.e., to future production.

141. Although the SCM Agreement does not address the issue of allocation directly, it does contemplate that subsidies will be allocated over time. In particular, Annex IV, paragraph 7, which addresses how to calculate the ad valorem subsidization of a product for purposes of a "serious prejudice" under Part III and Article 6.1(a), refers to pre-WTO subsidies whose benefits were "allocated to future production." This reference suggests that the allocation of subsidies is foreseen in the context of calculating the ad valorem subsidization of a product.[370]

142. Beyond that, the SCM Agreement does not take a position on how or even under what circumstances a subsidy should be allocated over time. Nevertheless, USDOC's use of its normal allocation methodology in the administrative reviews at issue is not in dispute.

143. Although the EC does not dispute USDOC's normal allocation methodology, repeatedly throughout its First Submission, the EC does negatively refer to the "irrebuttable presumption" that USDOC uses when applying its change-in-ownership methodology. In fact, the EC is confusing USDOC's change-in-

[369] *See* Part III.C., paras. 79-84 *supra*.

[370] Although Annex IV applies for purposes of WTO subsidy proceedings under Part III of the SCM Agreement, and it calls for the use of a cost-to-government measurement standard, most of the principles found in Annex IV would seem to apply equally to countervailing duty investigations under Part V of the SCM Agreement. For example, in countervailing duty investigations under Part V, the United States and other Members routinely apply the aggregation principles of paras. 2 and 6 of Annex IV when calculating *de minimis* rates, the principle of calculating benefits according to the most recent 12-month period espoused in paras. 2 and 3, the attribution principle of para. 3, the inflation principle of para. 5 and the allocation principle of para. 7.

ownership methodology with USDOC's normal allocation methodology. The "irrebuttable presumption" concept only applies to USDOC's normal allocation methodology, as can be seen from the discussion above at Part III.A., paragraphs 40-45. Moreover, this concept simply means that USDOC (like the investigating authorities in the EC and other Members) treats non-recurring subsidies as benefiting the subject merchandise over time, i.e., for a period of years.

144. Indeed, the EC uses an allocation methodology in its countervailing duty investigations that is similar to the United States' normal allocation methodology. A similar approach has also been endorsed by an Informal Group of Experts appointed by the Committee on Subsidies and Countervailing Measures to examine matters not specified in Annex IV.[371]

145. Notably, the allocation methodologies found in the countervailing duty laws of the United States and the EC and in the Informal Group of Experts' report do *not* require a determination in each year of the allocation period that there is a *continuing* benefit from a subsidy. Rather, the benefit determination is not revisited, and the allocation of the benefit is based solely on the conditions prevailing at the time of the subsidy bestowal.

146. In any event, as is shown in the Factual Background section above,[372] after identifying and measuring the subsidy benefits as of the time of the subsidy bestowals, USDOC followed its normal allocation methodology. It allocated the subsidy benefits over the period of years dictated by the facts in the record.

d) In Accounting for the Changes in Ownership at Issue, USDOC Applied an Approach that is Grounded in Fundamental Principles of the SCM Agreement and is Consistent with the Object and Purpose of the SCM Agreement

147. The final step taken by USDOC was to take account of the changes in ownership at issue, which it did through the methodology described at length in the Factual Background section above.[373]

148. USDOC's methodology was not dictated by the SCM Agreement, given that there is no direct guidance in the SCM Agreement about *how* to take into account a change in ownership. Indeed, the SCM Agreement does not even direct *whether* a change in ownership has to be taken into account, at least in the context of a Member's countervailing duty investigation under Part V of the SCM Agreement.

149. Nevertheless, USDOC's methodology is grounded in fundamental principles of the SCM Agreement found in Article 1.1 and Article 14. As is explained more fully above, consistent with Article 1.1, one basic premise of USDOC's methodology is that the subsidy "benefit" should be identified only once, as of

[371] *See* G/SCM/W/415/Rev.2.
[372] *See* Part III.C., paras. 85-86 *supra*.
[373] *See* Part III.C. *supra*.

the time of the subsidy bestowal, rather than be re-identified on a continuing basis at the time of any number of subsequent events.[374] In addition, consistent with Article 14, another basic premise of USDOC's methodology is that the subsidy "benefit" should be measured only once, as of the time of the subsidy bestowal, rather than re-measured at the time of some subsequent event.[375]

150. Meanwhile, beyond those premises, USDOC's methodology is consistent with the object and purpose of the SCM Agreement. As is explained more fully below in Parts IV.C.1.a. and b., the object and purpose of the SCM Agreement is to deter and offset trade-distorting government subsidies benefiting merchandise and causing injury to an industry in an importing country. Consistent with this object and purpose, USDOC's methodology helps to remedy the injurious trade distortions that result from government subsidization even after the ownership of the subsidy recipient has changed hands in an arm's length, fair market value transaction.

151. USDOC's methodology is also consistent with the only provision in the SCM Agreement that mentions a change in ownership, i.e., Article 27.13, one of the provisions setting out the rules governing subsidies actionable in a proceeding before the WTO under Part III of the SCM Agreement.

152. Article 27.13 provides:

> The provisions of Part III shall not apply to direct forgiveness of debts, subsidies to cover social costs, in whatever form, including relinquishment of government revenue and other transfer of liabilities when such subsidies are granted within and directly linked to a privatization programme of a developing country Member, provided that both such programme and the subsidies involved are granted for a limited period and notified to the Committee [on Subsidies and Countervailing Measures] and that the programme results in eventual privatization of the enterprise concerned.

153. This provision gives special and differential treatment to developing country Members. It creates an exception by establishing that certain types of subsidies provided by a developing country Member prior to privatization under certain circumstances will *not* be actionable after privatization. The strong implication - indeed, the only reasonable conclusion - is that the normal rule contemplated by the SCM Agreement is that subsidies bestowed on a government-owned company's production prior to privatization normally *are* actionable after privatization, i.e. the pre-privatization subsidies are allocable to the surviving privatized company's production. Specifically, it would seem to be contemplated that any types of pre-privatization subsidies provided by a developing country Member *other than* those described in Article 27.13, and *all* types of pre-privatization subsidies provided by a developed country Member, are allocable to the privatized company's production and therefore continue to be actionable after privatization.

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[374] *See* Part III.C., paras. 38-39 *supra*.
[375] *See* Part III.C., paras. 40-43 *supra*.

154. The principle of treaty interpretation *expressio unius es exclusio alterius*, meaning "to specify the one thing is to exclude the other," supports this interpretation of Article 27.13.[376]

155. While Article 27.13 by its terms only applies to WTO proceedings, it does provide context for interpreting Article 1.1 and its application in countervailing duty investigations. Moreover, given the nature of this issue, it is difficult to find support for the notion that the SCM Agreement envisions one rule for WTO proceedings and another rule - especially one that is directly the opposite, as the EC would have it - for countervailing duty investigations. Indeed, Article 27.13 is consistent with fundamental principles of the SCM Agreement - particularly, the "benefit" analysis contemplated by Article 1.1(b) - which apply to both WTO proceedings and countervailing duty investigations.

156. In this regard, consistent with the text of Article 1, one unstated premise of Article 27.13 is that the *identification* of a subsidy "benefit" under the SCM Agreement is to be made once, as of the time of the subsidy bestowal. By contemplating a general rule that the previously bestowed subsidies remain actionable and are allocable to the production of the surviving privatized company, i.e., the purchaser, Article 27.13 implicitly rejects the contrary notion that a subsidy "benefit" must be re-identified as of the time of the change in ownership.[377]

157. Consistent with Article 14, another unstated premise of Article 27.13 is that the *measurement* of an identified subsidy "benefit" under the SCM Agreement is to be made once, as of the time of the subsidy bestowal. Because Article 27.13 contemplates a general rule that the previously bestowed subsidies remain actionable and are allocable to the production of the purchaser, it also implicitly rejects the contrary notion that an identified subsidy "benefit" must be re-measured as of the time of the change in ownership.[378]

158. Further, implicit in Article 27.13 is the assumption that a subsidy benefits a product over time and, therefore, the subsidy should be allocated over time. This is the same assumption that generally underlies the SCM Agreement, as is evidenced by paragraph 7 of Annex IV, the practice of the investigating authorities in both the United States and the EC, and the Informal Group of Experts' report on Annex IV.[379]

159. Importantly, these same fundamental principles are found in US countervailing duty law, and they also underlie USDOC's change-in-ownership methodology, as is discussed above.[380]

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[376] *See* Lord McNair, The Law of Treaties at 400-10 (1961) (attached as Ex. USA-25).
[377] *See* Part IV.B.1.a. *supra*.
[378] *See* Part IV.B.1.b. *supra*.
[379] *See* Part IV.B.1.c. *supra*.
[380] Because USDOC developed its change-in-ownership methodology prior to the coming into force of the SCM Agreement, it did not then have occasion to reference Article 27.13. It did, however, address each of the fundamental SCM Agreement principles discussed above, given that these principles formed the foundation of US countervailing duty law both before and after the coming into force of the SCM Agreement. *See* notes 12 and 13 *supra*.

160. Article 27.13, meanwhile, does not provide any guidance regarding the *extent* to which pre-privatization subsidies continue to benefit the privatized company's production. Article 27.13's implicit general rule that pre-privatization subsidies continue to benefit the privatized company's production would seem to permit continuation of *all* pre-privatization subsidies or, as is true of USDOC's change-in-ownership methodology, continuation for only a *portion* of those subsidies. It is not possible to be any more specific. Either one of these approaches could be derived from Article 27.13's express exception stating that in certain situations *no* subsidies will remain actionable.

161. Given all of these circumstances, USDOC's methodology for accounting for a change in ownership does not violate - indeed, it is consistent with - the SCM Agreement.

e) The Unadopted *EC Lead Bar* GATT Panel Report does not Provide Relevant Guidance

162. The unadopted *EC Lead Bar* GATT panel report - which involved USDOC's 1993 final determination in the UK lead bar products investigation and which lead to the imposition of the countervailing duty order on UK lead bar products giving rise to the three administrative reviews now before this Panel - does not provide relevant guidance in connection with this dispute.[381]

163. In *EC Lead Bar*, the circumstances were unusual. USDOC had adopted a methodology calling for *full* continuation of pre-privatization subsidies when initially conducting its countervailing duty investigation. However, during ensuing litigation before the US Court of International Trade, USDOC voluntarily obtained a remand in order to change its methodology to coincide with its subsequent determination in the General Issues Appendix, which is USDOC's current *partial* continuation approach. Because the EC challenged USDOC's methodology prior to the court litigation, the only issue before the GATT panel was whether the initial methodology, which called for full continuation of prior subsidies, was consistent with the GATT Subsidies Code.[382]

164. Before the GATT panel, the EC argued, as it does here, that there was no continuing benefit to the purchaser following a privatization that took place at arm's length and for fair market value. In the EC's view, all prior subsidies were extinguished.[383]

165. The United States, meanwhile, did not attempt to defend an approach that called for full continuation of prior subsidies.[384] It instead referenced its current

[381] *United States - Imposition of a Definitive Countervailing Duty on Imports of Certain Steel Products Originating In France, Germany, and the United Kingdom*, Report of the GATT Panel, SCM/185, issued 15 November 1994 (unadopted) ("*EC Lead Bar*").
[382] Ibid., paras. 406-11.
[383] *United States - Imposition of a Definitive Countervailing Duty on Imports of Certain Steel Products Originating In France, Germany, and the United Kingdom*, Report of the GATT Panel, SCM/185, issued 15 November 1994 (unadopted) ("*EC Lead Bar*"), para. 413.
[384] Ibid., para. 425.

approach and argued that it was reasonable to "allocate" the subsidy benefit found as of the time of the subsidy bestowal between the seller and the purchaser in a privatization transaction based, in part, on the amount of the purchase price.[385]

166. In its ruling, the panel did not adopt either the EC view or the United States view. It instead explained simply that both the EC and the United States agreed that the purchase price should have been taken into account in some way, and solely on that basis the panel found the full continuation approach to be inconsistent with the GATT Subsidies Code. Thus, the panel noted that

> the parties differed on the question of how the purchase price paid ... should have been taken into account by the DOC. However, the common element in the approaches of the parties as presented to the Panel was that the purchase price was at least a relevant fact to consider.[386]

The panel concluded that the full continuation approach "was not based on a consideration of all relevant facts," as required by Article 1 of the GATT Subsidies Code.[387]

167. USDOC's current methodology, which is at issue in this dispute, does take into account the purchase price. In fact, USDOC makes the purchase price in a change-in-ownership transaction one of the principal factors influencing its apportionment of the subsidy benefit between the seller and the purchaser.

168. Thus, USDOC's methodology is wholly consistent with whatever guidance can be extrapolated from the unadopted *EC Lead Bar* GATT panel report.

C. The EC Fails to Establish that the United States Violated any of its Obligations under the SCM Agreement

169. In its First Submission, the EC's principal argument is that USDOC did not comply with Article 10 of the SCM Agreement because it did not take all necessary steps to ensure that its imposition of countervailing duties conformed to the requirements of the SCM Agreement. The key step which USDOC failed to take, in the EC's view, was the identification of a subsidy "benefit" within the meaning of Article 1.1(b) after ownership of the subsidy recipient changed hands. In a related argument, the EC invokes Article 19.4 and asserts that USDOC imposed countervailing duties in excess of the amount of the subsidy that should have been found to exist and measured after the ownership change.

170. The United States explains in detail below why the EC's two arguments lack merit.

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[385] Ibid., paras. 415, 423-25.
[386] Ibid., para. 426.
[387] Ibid., para. 427. The requirement under Article 1 of the GATT Subsidies Code to consider all relevant facts is now found in Articles 12 and 22 of the SCM Agreement, neither of which the EC invokes in this dispute.

171. The United States also notes that the practice of the EC under its State Aids Code, which the EC follows in significant respects when implementing its countervailing duty law, is directly the opposite of the legal and economic positions which it advocates in its two arguments.

1. USDOC did not Violate Article 10 of the SCM Agreement Because it did not Fail to Take all Necessary Steps to Ensure that its Imposition of Countervailing Duties Conformed to the Requirements of the SCM Agreement

172. In this dispute, the EC attempts to discredit USDOC's approach to changes in ownership essentially by urging the adoption of two rules which it views as being *required* by the SCM Agreement. The first rule is that the investigating authority is required to identify and measure the *continuing* benefit of a subsidy as of a time that was years after its bestowal. The second rule is that a change in ownership accomplished through an arm's length, fair market value transaction by definition eliminates all previously bestowed subsidies. The EC insists that, as an economic matter, the purchaser of the government-owned company paid what the prior subsidies were worth, and therefore no subsidies - specifically, no subsidy "benefits" within the meaning of Article 1.1(b) - can be identified with regard to that company once it is operating under its new owner, i.e., the purchaser.[388] The EC also urges this same approach with regard to the sale of a unit of a government-owned company, i.e., the 1986 spin-off of UES.

173. Before the Panel could adopt these rules, as the EC itself recognizes, certain legal prerequisites must be established under the SCM Agreement. At a minimum, it must first be shown that the SCM Agreement *requires* the investigating authority to make a "benefit" determination under Article 1.1(b) as of a time years after the subsidy bestowal, i.e., as of a change in ownership.

174. In any event, the EC begins its argument by stating that Article 10 requires the investigating authority to take "all necessary steps" to ensure that its imposition of countervailing duties conforms to the requirements of the SCM Agreement.[389] The EC then attempts to show that USDOC did not follow this mandate.

175. First, the EC makes the point that the investigating authority must identify the existence of a "subsidy" before addressing other SCM Agreement requirements, such as measuring and allocating the amount of the subsidy found to exist or imposing a countervailing duty.[390]

176. Then, the EC turns to the provision that directly addresses the identification of the subsidy "benefit," namely, Article 1.1. Here, the EC begins by endorsing the definition of the Article 1.1 term "benefit" put forth by the panel in

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[388] It is the purchaser in each of the change-in-ownership transactions at issue which is the producer of the subject merchandise and, consequently, the focus of the analysis.
[389] EC's First Submission at 28, 33.
[390] Ibid. at 33-34.

Canada Civilian Aircraft, which is that "benefit" means "an advantage."[391] However, the EC then argues that Article 14's use of various commercial benchmarks to measure the subsidy benefit provides relevant context for interpreting Article 1.1, and from there it extrapolates to a new definition of "benefit" as meaning a "*commercially meaningful* advantage."[392]

177. Next, the EC reaches the crux of its legal argument. It argues that the investigating authority is required to establish that a "benefit" within the meaning of Article 1.1(b), or a "commercially meaningful advantage," was not simply conferred with the subsidy at issue but also that it was "conferred on the party whose imports [are to] be countervailed," i.e., the firm under investigation.[393] Citing only to the object and purpose of the SCM Agreement rather than the text of Article 1.1 or the context provided by Article 14,[394] the EC asserts that the investigating authority's obligation to first identify the existence of a subsidy

> cannot and does not end with a determination that an unrelated party at some point in the past received a subsidy. It must be demonstrated ... that *the party under investigation*, whose goods are the ones subject to an *offsetting* countervailing duty, was the recipient of a subsidy.[395]

178. The EC then explains what this principle means in the context of a change in ownership. Essentially, according to the EC, it means that the investigating authority must identify a *continuing* benefit to the purchaser - or, more precisely, a *continuing* "commercially meaningful advantage" to the purchaser - as of the time that the ownership of the subsidy recipient changes hands.[396]

179. Finally, to support its conclusion that there is no continuing benefit under the record facts in the administrative reviews at issue, the EC makes an economic, rather than a legal, argument. According to the EC, the benefits provided to a company by previously bestowed subsidies would not be realized by the purchaser because the purchaser would have paid in full for those benefits as part of the purchase price, assuming that the transaction was made at arm's length and

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[391] EC's First Submission at 35 n.77 (quoting *Canada – Aircraft*, *supra*, footnote 70, para. 9.112).

[392] Ibid. at 35-36 (emphasis in original).

[393] Ibid. at 37.

[394] During the course of this argument, the EC also refers to Article 19.1 for the proposition that a Member cannot impose a countervailing duty if the subsidy is "withdrawn." The EC then insists that "[t]he fact that a government recovers the residual value of any subsidies that it has granted in the past through a fair market value and arm's length sale of the assets of the previous beneficiary must be one of the means by which the subsidy can be 'withdrawn.'" Ibid. at 33. The United States addresses this argument in Part C.2. below.

[395] During the course of this argument, the EC also refers to Article 19.1 for the proposition that a Member cannot impose a countervailing duty if the subsidy is "withdrawn." The EC then insists that "[t]he fact that a government recovers the residual value of any subsidies that it has granted in the past through a fair market value and arm's length sale of the assets of the previous beneficiary must be one of the means by which the subsidy can be 'withdrawn.'" at 34 (emphasis in original).

[396] During the course of this argument, the EC also refers to Article 19.1 for the proposition that a Member cannot impose a countervailing duty if the subsidy is "withdrawn." The EC then insists that "[t]he fact that a government recovers the residual value of any subsidies that it has granted in the past through a fair market value and arm's length sale of the assets of the previous beneficiary must be one of the means by which the subsidy can be 'withdrawn.'" at 34, 35-36, 37-38.

the purchase price therefore represented the fair market value of the company.[397] On this basis, the EC concludes that

> where a privately-owned company has purchased a company at fair market value in an arm's-length transaction, there can be no benefit conferred on the purchaser ... . [The] purchaser ... is not in any way put in a more advantageous position in comparison to the market. ... An advantage would be granted to a buyer only if it were to purchase the firm at *less* than fair market value as the result of a seller favouring one of the bidders unfairly. In order to determine that the new privately-owned company has obtained a "benefit", a Member's investigating authorities must prove that the current producer/exporter has obtained the assets under circumstances inconsistent with commercial considerations.[398]

180. Below, the United States addresses, and refutes, the EC's argument. As will be shown, the EC errs at every step in its analysis, and the Panel therefore should reject the EC's argument.

a) The SCM Agreement does not Require the Investigating Authority to Establish that the Firm under Investigation was the Recipient of the Subsidy before it Levies Duties; Consequently, there is no Legal Basis for a Requirement that the Investigating Authority Identify a Continuing Benefit to the Purchaser when the Ownership of the Subsidy Recipient Changes Hands

181. The EC is making a crucial - yet unsupportable - assumption when it argues that the investigating authority is required to make another "benefit" determination when the ownership of the subsidy recipient changes hands, given that the SCM Agreement requires the investigating authority to establish that the firm

[397] During the course of this argument, the EC also refers to Article 19.1 for the proposition that a Member cannot impose a countervailing duty if the subsidy is "withdrawn." The EC then insists that "[t]he fact that a government recovers the residual value of any subsidies that it has granted in the past through a fair market value and arm's length sale of the assets of the previous beneficiary must be one of the means by which the subsidy can be 'withdrawn.'" at 20-25, 35, 37. Here, it is important to note that the EC is not asserting that the purchaser paid the full amount of the subsidy benefit identified, measured and allocated as of the time of the subsidy bestowal. Rather, the EC's assertion of no benefit is based on a re-evaluation of the subsidy benefit's worth as of the time of the change-in-ownership transaction. The EC is not actually able to state what the subsidy benefit is worth at that time. However, according to the EC, the purchaser pays exactly what the company is worth at that time, and part of the value of the company is represented by the actual present value of all previously bestowed subsidies attributable to it.

[398] During the course of this argument, the EC also refers to Article 19.1 for the proposition that a Member cannot impose a countervailing duty if the subsidy is "withdrawn." The EC then insists that "[t]he fact that a government recovers the residual value of any subsidies that it has granted in the past through a fair market value and arm's length sale of the assets of the previous beneficiary must be one of the means by which the subsidy can be 'withdrawn.'" at 37 (emphasis in original).

under investigation was the subsidy recipient before it may impose duties. The EC is assuming that when the ownership of the subsidy recipient changes hands, the successor firm is unrelated to, and different from, the subsidy recipient. Plainly, while the owners may be different and unrelated, the productive assets which benefited from the subsidy before the change in ownership are the same ones used by the new owners after the change in ownership. Which factor is determinative? The SCM Agreement, of course, does not specifically answer this question, as it does not directly address changes in ownership. More to the point, however, the SCM Agreement does not contemplate that the investigating authority will make a benefit determination other than the one made as of the time of the subsidy bestowal. Nevertheless, if there is an answer in the SCM Agreement, it would seem to be that the productive assets - not the owners - would be the determinative factor, given that GATT 1994 Article VI:3 and Article 10 of the SCM Agreement refer to the "subsidy" as having been "bestowed, directly or indirectly, upon the manufacture, production or export of" the product, as is discussed more fully below. What this means, then, is that the successor firm really is no different from the subsidy recipient, and consequently there is no need - even under the EC's theory - for a second benefit determination after the change in ownership.

182. Independent of this flaw in the EC's argument, the United States also strongly disagrees with the EC's equally crucial assertion that it is necessary for the investigating authority to demonstrate that the firm under investigation was the actual recipient of the subsidy before it may impose duties.

183. First of all, this assertion in no way follows from the fact that the investigating authority must first identify the existence of a subsidy before measuring and allocating the amount of the subsidy found to exist or imposing a countervailing duty. The simple requirement that the investigating authority begin its analysis by first identifying the existence of a subsidy does not shed any light on the question whether the identified benefit must be the one bestowed originally or whether a *continuing* benefit must be identified with regard to the new owner of the subsidy recipient.[399] In fact, as is shown in Part IV.B.1.a. above, the SCM Agreement only requires that the investigating authority find a benefit to the original recipient of the subsidy.

184. The same assessment is true of the EC's assertion that "benefit" really means "commercially meaningful advantage." Even if this assertion were correct,[400] it begs the question of whether the SCM Agreement requires the benefit

[399] The United States agrees that the investigating authority must first identify the existence of a subsidy, i.e., a "financial contribution" and a "benefit," before measuring and allocating the amount of the subsidy found to exist or imposing a countervailing duty. The United States notes, however, that when the investigating authority uses the benefit-to-recipient measurement standard, the act of identifying the benefit (under Article 1) is normally the same as measuring the benefit (under Article 14). The separate act of allocating the identified and measured benefit over time can only be done afterwards.

[400] The United States does not dispute that the ordinary meaning of the term "benefit" in Article 1.1(b) is "advantage." Nevertheless, the United States would suggest that the term "benefit" in Article 1.1(b) is essentially defined in Article 14, where the SCM Agreement addresses four common

to be established once, as of the time of the subsidy bestowal, or also as of a time years later when the ownership of the subsidy recipient changes hands.

185. Furthermore, it is especially significant that the EC does not rely on the text of the provision that directly governs the identification of the subsidy benefit, i.e., Article 1.1(b), or even the context provided by the measurement provisions of Article 14, when it attempts to support its crucial assertion that it is necessary for the investigating authority to demonstrate that the firm under investigation was the subsidy recipient before it may impose duties. Instead, the only support that the EC offers is what it (erroneously) views as the object and purpose of the SCM Agreement, which, according to the EC, is the imposition of duties to offset the continuing subsidy benefit received by the firm under investigation.[401]

186. As a preliminary matter, it should be noted that the panel in *Canada Civilian Aircraft* recently cautioned that

> the SCM Agreement does not contain any express statement of its object and purpose. We therefore consider it unwise to attach undue importance to arguments concerning the object and purpose of the SCM Agreement.[402]

The EC, of course, attaches extreme importance to (its interpretation of) the object and purpose of the SCM Agreement. It relies almost exclusively on it to support its assertion that the investigating authority must demonstrate that the firm under investigation was the recipient of the subsidy. Under these circumstances, this Panel should follow *Canada Civilian Aircraft* and not allow the EC to support this assertion with (its interpretation of) the object and purpose of the SCM Agreement.

187. What this means, as a practical matter, is that the Panel should reject the EC's assertion that the investigating authority must demonstrate that the firm under investigation was the recipient of the subsidy. Without (the EC's interpretation of) the object and purpose of the SCM Agreement, there is no support for it.

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forms of subsidies and states precisely what the benefit is in each situation. Beyond that, the only definition of "benefit" necessary in this dispute is already provided by Article 14 for the subsidies at issue. For example, para. (a) of Article 14 describes the benefit when the government provides equity capital to a firm, as it did in this case. It is precisely this provision that controls here. The EC is arguing that the financial contribution originally provided by the UK Government, in the form of equity infusions benefiting the production of the subsidy recipient, BSC, does not confer a benefit on the production of BSC's successor, BS plc. In other words, the EC is addressing the originally bestowed equity infusions, and it argues that while they did initially confer a benefit, they no longer confer a benefit several years later as of the time of the change in ownership of the subsidy recipient. The EC is trying to assess whether the originally bestowed equity infusions continue to provide the requisite benefit under Article 1.1(b) after the change in ownership of BSC (even though the EC does not contest the 18-year allocation period used by USDOC). The basis for making that determination, the United States submits, is set forth in Article 14(a), not some abstract notion of whether a "commercially meaningful advantage" has been conferred. As shown above in Part III.C., para. 74, moreover, the UK Government's equity infusions did confer the requisite benefit under Article 1.1(b).

[401] Ibid. at 29-32, 34, 37-39.

[402] Panel Report *Canada - Aircraft, supra,* footnote 70, para. 9.119, Notice of Appeal filed 3 May 1999.

The only other support which the EC offers consists of two pre-WTO GATT panel reports, and the EC only cites these reports - which are inapposite, as shown below - to confirm (its interpretation of) the object and purpose of the SCM Agreement.[403]

188. Perhaps even more fundamentally, in the United States' view, the EC has misstated the object and purpose of the SCM Agreement as being the imposition of duties to offset the continuing subsidy benefit received by the firm under investigation. The object and purpose of the SCM Agreement is, in fact, to deter and offset trade-distorting government subsidies benefiting merchandise and causing injury to an industry in the importing country.

189. In this regard, a review of the SCM Agreement reveals two fundamental requirements that must be met before a Member's investigating authorities may impose countervailing duties. First, a subsidy must have been provided with respect to the manufacture, production or sale of a product, as can be seen from Articles 1, 10 and 19.4 of the SCM Agreement and GATT 1994 Article VI:3. Second, a domestic industry must be suffering injury by reason of imports of the product into the territory of the Member, as can be seen from Article 15 of the SCM Agreement and GATT 1994 Article VI:6(a).

190. The EC only addresses the first of these two fundamental requirements, and even then it misstates it.[404]

191. With regard to the first fundamental requirement, the SCM Agreement does not focus on the *subsidy recipient*, as the EC maintains. Rather, it focuses on the *merchandise* and, in particular, on subsidies bestowed on the manufacture, production or export of the merchandise.

192. The SCM Agreement's focus on the merchandise is evident, in the first instance, in Article VI of GATT 1994, the provision of GATT 1994 which the SCM Agreement applies in establishing the rules for Members' countervailing duty proceedings. Specifically, paragraph 3 of Article VI provides:

> No countervailing duty shall be levied *on any product* of the territory of any Member imported into the territory of another Member in excess of the amount equal to the estimated bounty or subsidy determined to have been granted, directly or indirectly, *on the manufacture, production or export of such product* in the country of origin or exportation ... . The term "countervailing duty" shall be understood to mean a special duty levied for the purpose of offsetting any bounty or subsidy bestowed, directly, or indirectly, *upon the manufacture, production or export of any merchandise*. (Emphasis added.)

193. These same principles are re-stated in Articles 10 and 19.4 of the SCM Agreement in virtually the same terms.

194. Article 10 provides in relevant part:

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[403] *See* EC's First Submission at 38-39.
[404] *See id.* at 29-32.

> Members shall take all necessary steps to ensure that the imposition of a countervailing duty *on any product* of the territory of any Member imported into the territory of another Member is in accordance with the provisions of Article VI of GATT 1994 and the terms of this Agreement. ... (Emphasis added.)

In an accompanying footnote, it adds:

> The term "countervailing duty" shall be understood to mean a special duty levied for the purpose of offsetting any subsidy bestowed directly or indirectly *upon the manufacture, production or export of any merchandise*, as provided for in paragraph 3 of Article VI of GATT 1994. (Emphasis added.)

195. Similarly, Article 19.4 provides:

> No countervailing duty shall be levied *on any imported product* in excess of the amount of the subsidy found to exist, calculated in terms of subsidization per unit of the subsidized and exported product. (Emphasis added.) (Footnote omitted.)

196. All of these provisions focus on the subject merchandise and provide that the countervailing duty shall be imposed on the product, not the subsidy recipient. Nowhere do these provisions mention the producer or exporter of the merchandise, whether it be the original subsidy recipient, the firm under investigation or any other firm.

197. Similarly, these provisions set the countervailing duty that may be imposed by the investigating authority at an amount equal to the subsidy bestowed on the manufacture, production or export of the product. Again, there is no mention of the producer or exporter itself, as the SCM Agreement remains focused only on the product being exported (and causing injury) rather than the identity of the producer or exporter.

198. Importantly, these points go beyond mere semantics. Again, the so-called "trading company" example provides helpful clarification. Here, as will be recalled, it is assumed that a heavily subsidized UK producer sells a quantity of its products to an unrelated UK trading company in an arm's length transaction at fair market value, and then the trading company turns around and sells the products in the United States. In this scenario, if Article 1.1 or any other provision of the SCM Agreement required the producer or exporter of the subject merchandise to have been the direct recipient of the subsidies being countervailed, the sale to the UK trading company automatically would have extinguished the subsidies previously bestowed on the UK producer. The result would be irrational, particularly because the US domestic industry would have suffered the same injury regardless of whether the imports came from the UK trading company or the UK producer. The SCM Agreement again avoids such irrational results by not requiring the producer or exporter of the subject merchandise to be the direct recipient of the subsidies being countervailed.

199. Even more importantly, these provisions do not *require* the investigating authority to determine the actual *effect* of the subsidy on the subsidy recipient at any time after its bestowal, contrary to the EC's argument that the investigating authority must determine whether there is a *continuing* benefit from the subsidy

(in the circumstance where the ownership of the subsidy recipient changes hands). Instead, these provisions authorize the imposition of the countervailing duty simply in the amount of the subsidy, without any regard for its actual effect on the subsidy recipient.

200. Indeed, the *only* "effects" inquiry contemplated by the SCM Agreement - which is the one referred to in Article 19.2 - applies to the investigating authority's determination of "injury." Specifically, in Article 15.5, the SCM Agreement provides that "[i]t must be demonstrated that the subsidized imports are, through the effects of subsidies, causing injury within the meaning of this Agreement." An accompanying footnote explains that the phrase "the effects of subsidies" refers to certain effects of the subsidies on the domestic industry in the importing country. These effects are set forth in paragraphs 2 and 4 of Article 15 and include the volume of subsidized imports, their effect on prices and the consequent impact on domestic producers.

201. It is true that the SCM Agreement does *permit* the investigating authority to impose a countervailing duty in an the amount that would be less than the amount of the subsidy. In this regard, Article 19.2 provides that "[i]t is desirable that ... the duty should be less than the total amount of the subsidy if such lesser duty would be adequate to remove the injury to the domestic industry ...." Nevertheless, Article 19.2 is still not concerned with the effect of the subsidy on the *subsidy recipient*. Rather, as with injury under Article 15, it is only the effect of the subsidy on *the domestic industry in the importing country* with which the SCM Agreement is concerned.

202. Otherwise, the SCM Agreement does not inquire into the effects of a subsidy.

203. Certainly, the two provisions which directly address the identification of the subsidy benefit - Article 1.1 and Article 14 - do not contemplate an inquiry into the effects of a subsidy. As is discussed above, these two provisions only direct the investigating authority to the circumstances as they existed *at the time of the subsidy bestowal* when undertaking the identification and measurement of the subsidy "benefit." Like US countervailing duty law, these two provisions seem to reflect an assumption that the subsidy will have effects over time, i.e., that the subsidy will benefit future production of the subject merchandise. Although the SCM Agreement does not explain why it makes this assumption, one likely reason is the one offered by USDOC in the context of US countervailing duty law. As USDOC explained, while subsidies are considered to be "distortions in the market process for allocating an economy's resources,"[405] it is not feasible - indeed, it is burdensome and unproductive, if not impossible - for the investigating authority to show how those distortions may have occurred in any particular instance of subsidization.[406]

204. Thus, these various provisions confirm that the first fundamental requirement of the SCM Agreement is that a subsidy have been provided with respect to

[405] General Issues Appendix, 58 Fed. Reg. at 37260.
[406] *See* Part III.A., paras. 49 and 57 *supra*.

the manufacture, production, or sale of a product. When this requirement is read together with the injury determination required by Article 15, the appropriate formulation of the object and purpose of the SCM Agreement becomes clear. The object and purpose of the SCM Agreement is to deter and offset trade-distorting government subsidies benefiting merchandise and causing injury to an industry in an importing country.

205. Notably, the panel in *Canada Civil Aircraft* basically agreed with this formulation of the object and purpose of the SCM Agreement. It stated that "the object and purpose of the SCM Agreement could more appropriately be summarized as the establishment of multilateral disciplines 'on the premise that some forms of government intervention distort international trade, [or] have the potential to distort [international trade].'"[407]

206. Indeed, the EC itself, in its own countervailing duty law, has previously described the object and purpose of the SCM Agreement in line with the United States' view. According to the EC, a countervailing duty may be imposed

> for the purpose of offsetting any subsidy granted, directly or indirectly, for the manufacture, production, export or transport of any product whose release for free circulation in the Community causes injury.[408]

207. Meanwhile, the two pre-WTO GATT panel reports to which the EC cites - *Canadian Pork*[409] and the unadopted *EC Lead Bar* report - also do not support the EC's formulation of the object and purpose of the SCM Agreement.

208. In *Canadian Pork*, the panel focused entirely on production, not the owners of the subsidy recipient. The panel determined that a subsidy benefiting the raising of hogs did not necessarily benefit pork production. According to the panel, in this type of "upstream subsidy" situation, it is necessary to show that the subsidy on the upstream product (hogs) benefits the downstream product (pork), which was the product under investigation. In contrast, in this dispute, there is no upstream subsidy issue. All of the subsidies at issue were provided to benefit steel production. The issue in the dispute before this Panel is whether the benefit which the EC concedes was originally provided to BSC's production must be disregarded because the ownership of BSC's lead bar production assets changed hands. Thus, to the extent that *Canadian Pork* is relevant to this dispute, it is because it supports the United States' argument that the proper focus of the Panel's analysis should be on the merchandise, not on the subsidy recipient.

209. *EC Lead Bar* is no different. Indeed, the EC relies on it because of the panel's discussion of Article 1, footnote 4, of the GATT Subsidies Code, which is essentially the same as Article 10, footnote 36, of the SCM Agreement. Here, the

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[407] *Canada Civilian Aircraft*, at para. 9.119.

[408] Council Regulation (EC) No. 2026/97 of 6 October 1997 on protection against subsidized imports from countries not members of the European Community, OJ L 288, at Article 1.1 (Principles) (attached as Ex. USA-26).

[409] *United States - Countervailing Duties on Fresh, Chilled and Frozen Pork from Canada*, DS/7R, Report of the GATT Panel, adopted 11 July 1991.

panel refers to the "subsidy" as being "bestowed on the production of the merchandise."[410] Again, this language is virtually identical to the language found in GATT 1994 Article VI:3 and the footnote to Article 10 of the SCM Agreement, which, as discussed at length above, supports the United States' formulation, rather than the EC's formulation, of the object and purpose of the SCM Agreement.

210. Thus, unable to rely on anything other than its own erroneous interpretation of the object and purpose of the SCM Agreement, the EC is left with *no* support for its crucial assertion that the investigating authority must demonstrate that the firm under investigation was the recipient of the subsidy before it may impose duties.

211. Without any support for this assertion, the EC is left with *no* legal basis for its ensuing explanation of what this assertion (if accepted as accurate) means in the change-in-ownership context. In other words, there is no legal basis for a requirement that the investigating authority identify a *continuing* benefit to the purchaser when the ownership of the subsidy recipient changes hands.

b) The Economic Component of the EC's Argument is not only Overly Simplistic, but also, more Fundamentally Misplaced

212. The highlighted discussion of the "economics of privatization" in the EC's First Submission should not distract the Panel from the legal prerequisites that must be established under the SCM Agreement before economic theory even becomes relevant in this dispute. Indeed, as shown above, the EC fails to meet its burden of establishing these legal prerequisites, and therefore the soundness of the EC's economic theory need not even be addressed by the Panel. Nevertheless, it still may be important for the Panel to understand that the economic component of the EC's argument is overly simplistic and, more fundamentally, misplaced.

213. The EC cites to various sources regarding accepted valuation techniques in various types of business transactions, and from there it extrapolates to the conclusion that the purchaser in an arm's length, fair market value privatization transaction pays exactly what the government-owned company, including all previously received subsidies, is worth. On that basis, the EC asserts that the purchaser realizes no continuing "commercially meaningful advantage".

214. The EC's discussion of the economics of privatization is misplaced from the start due to its focus on the purchaser rather than on what is being purchased, i.e., subsidized production. Specifically, the EC's economic analysis is constricted by the EC's own misinterpretation of the object and purpose of the SCM Agreement as being the imposition of duties to offset the continuing subsidy benefit received by the firm under investigation in a countervailing duty proceeding. More appropriately, any discussion of the economics of privatization should begin with a recognition that the object and purpose of the SCM Agree-

[410] EC's First Submission at 38 (quoting *EC Lead Bar*, para. 420).

ment is to deter and offset trade-distorting government subsidies benefiting merchandise and causing injury to an industry in an importing country.[411]

215. From this perspective, the inadequacy of the EC's focus on the purchaser becomes evident. This focus does not address the trade distortions which subsidies cause, particularly in the context of the market in a heavily subsidized industry like the steel industry.

216. In an industry like the steel industry, excess capacity, often brought on by the very same massive government subsidization which the EC assumes away, can distort the market tremendously.[412] Where the government provides massive subsidies to an industry, companies are enabled to continue building and modernizing production facilities and producing output even where output exceeds demand. The resulting excess capacity and excess output drive down the value of the companies in this industry as well as the prices of the industry's overall output.

217. In contrast, under normal market conditions, where the government has *not* provided massive subsidies to an industry, the marketplace would perform its accustomed role as impartial arbiter in the allocation of resources. If the market signalled through increased demand that more output were needed, companies would respond to those signals by devoting more resources to output. If the market signalled through stagnant (or declining) demand that no more (or even less) output were needed, no additional (or even fewer) resources would be devoted to production. Efficient companies would survive, and inefficient ones would not (and should not) survive, while output prices would not be artificially depressed.

218. Consequently, under normal market conditions, if a particular company in this unsubsidized industry were to be sold, it would command a higher market price than would the same company if the industry were heavily subsidized because there would be no excess capacity or excess output from inefficient, subsidized companies to depress the market price of the company. What this means for a company in a heavily subsidized industry is that, *but for* government subsidization of the industry, the market price of that company (and all other companies) would be higher.

219. These dynamics, at the very least, call into question the significance of a depressed fair market price in a privatization transaction, even accepting *arguendo* the EC's focus on the "commercially meaningful advantage" to the purchaser.[413]

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[411] *See Canada – Aircraft*, *supra*, footnote 70, para. 9.119.

[412] Notably, the EC itself recognizes in its State Aids Code, discussed below in Part IV.C.1.c., that a more relevant economic analysis would attempt to take into account the serious economic effects of the excess capacity likely created by a government's massive subsidization, given that it is a problem that would survive an arm's length, fair market value change-in-ownership transaction. In fact, the EC lists the creation of excess capacity as one of the principal problems resulting from government subsidization. *See* Guidelines for State Aid for Rescuing and Restructuring Firms in Difficulty, OJ C 283/02, 19.09.97, at paras. 2.1 and 3.2.2(ii) (attached as Ex. USA-27).

[413] Additionally, in an industry like the steel industry, government subsidies or other policies often are used to keep a company (like BSC) afloat and available for purchase well after it likely would

220. More fundamentally, these dynamics call into question whether it is sound to treat the price paid for a government-owned company in a heavily subsidized industry as automatically extinguishing the considerable amount of subsidies previously bestowed upon it, as the EC wants the Panel to conclude. Despite the fair market nature of the price paid for the company, the original subsidies continue to distort trade, through artificially high output, through artificially low output prices resulting from the excess capacity which they created and through the reduced value of companies throughout the industry.

221. For example, government subsidization, particularly when it reaches levels like *seven billion pounds* as in this dispute, can dramatically increase the competitiveness of a steel company by financing extensive modernization of facilities and the use of the most advanced production technologies, along with whatever training of workers is necessary, among other things. The sale of that company at a fair market price does not remove the subsidy-induced distortion caused by the company's strengthened steel production capabilities.

222. The EC, meanwhile, uses the example of a subsidized chair being sold at different prices under different scenarios in order to support its theory about the arm's length, fair market value nature of a privatization transaction. This example, however, fails to capture the economic aspects of privatization in industries like the steel industry, where privatizations typically take place. Simply put, a chair is not a steel company. The sale of an additional unneeded chair is unlikely to adversely affect the price of chairs in the marketplace or cause other distortions. On the other hand, the continued existence of a subsidized steel company, which otherwise would have been idled by, or had its output substantially restricted by, the impartial marketplace, has severe economic repercussions, as shown above.

223. A better understanding of the economic aspects of privatization in an industry like the steel industry can be seen in the following example. Suppose that a young man who lives in a small town has a very rich uncle. One day, the rich uncle decides that the young man needs a career, and he builds and gives to his nephew a large apartment building, notwithstanding the fact that there is no need for additional rental units in the town. By the time the apartment building is completed, the vacancy rate for dwellings in the town has doubled, thereby depressing the entire real estate market. Consequently, the nephew decides to sell the building at a price established by competent, independent appraisers. Because the excess capacity in the town has depressed the rental price for apartment units, the price at which the apartment building (or any other residential rental properties) can be sold has fallen significantly. The nephew can only sell it at a price about

have ceased to exist under normal market conditions. Not only does this lead to excess capacity and a reduced fair market price, as discussed above, but it also can provide a benefit to any purchaser of that company in another way. Here, a benefit arises to the extent that the purchaser is able to obtain that company at a price below the cost of building comparable new steel facilities, when that company should not even exist under normal market conditions and no comparable companies in the industry are available for sale.

one-half of what it cost to build. Nevertheless, this price represents 100 per cent of the apartment building's current market value on the date of sale.

224. Whether the purchaser of the apartment building received a "commercially meaningful advantage" as a result of the rich uncle's original gift to the nephew is open to conjecture. The more appropriate consideration is the market distortions caused by that gift. Simply because the purchaser paid the current market price, it does not follow that the apartment building no longer has any adverse effect on the real estate market or on competitors in that market. To the contrary, other owners of residential rental properties have seen their rents decline as a result of that building, just as they have also seen the overall value of their properties decline. The fact that the purchaser of the nephew's apartment building cannot charge more than the other property owners does not immunize the other property owners from the adverse effects caused by the continued existence of that building.

225. The point of this example is that it makes no difference whether the price at which the nephew's apartment building is sold is based on what is deemed to be an arm's length, fair market price. Rather, the fact that there are now additional rental units, for which the market did not signal a need, is continuing to have adverse effects on both rental prices and the value of residential rental properties generally. Moreover, these adverse effects are the same ones that were caused by the apartment building when it was first built.

226. For these reasons, independent of the legal infirmities confronting the EC's argument, the Panel would not have a sound basis for finding the economic component of the EC's argument to be *required* by the SCM Agreement.

c) The EC's Own Practice is Directly the Opposite of the Rule which, According to the EC, is Required by the SCM Agreement

227. Although the EC has not yet addressed the change-in-ownership issue under its countervailing duty law, it has done so under its State Aids Code, a law pursuant to which the EC internally regulates member State subsidization. Significantly, the approach taken by the EC under its State Aids Code directly contradicts its position in this dispute.

228. Under its State Aids Code, the EC does *not* treat an arm's length, fair market value change-in-ownership transaction as extinguishing prior subsidies. Rather, it takes the exact opposite approach and treats the prior subsidies as automatically continuing, in full, to the benefit of the purchaser.

229. Paragraph 2.3 of the EC's Guidelines for State Aid for Rescuing and Restructuring Firms in Difficulty[414] is the actual provision that addresses this issue. It provides in relevant part:

> The assessment of rescue and restructuring aid is not affected by changes in ownership of the business aided. Thus, it will not be

[414] OJ C 283/02, 19.09.97.

possible to evade control by transferring the business to another legal entity or owner.

230. Notably, the State Aids Code - including the EC's Guidelines for State Aid for Rescuing and Restructuring Firms in Difficulty - has underpinnings that are similar to those of the countervailing duty law. Just as the countervailing duty law regulates the subsidization of firms, so does the State Aids Code, although its focus is on the subsidization of firms within and among the member States that comprise the EC's single market. In addition, like the countervailing duty law, the State Aids Code is founded on a general recognition of the "distortive effect" of State aid and how this distortive effect "is magnified as other government-induced distortions are eliminated and markets become more open and integrated."[415] For these reasons, the EC generally prohibits internal subsidization, although there are exceptions for special circumstances. One of these exceptions involves State aid for rescuing or restructuring firms in difficulty, which is the subject of the Guidelines discussed above. Here, the EC continues to recognize that "State aid for rescuing or restructuring firms in difficulty will, by its very nature, tend to distort competition and affect trade between Member States," but it permits certain limited types of State aid in certain circumstances where it is "in the Community interest."[416]

231. Although the United States recognizes that the State Aids Code may have a different overall purpose from the EC's countervailing duty law, the United States submits that the underlying rationale for the two sets of rules - and, in particular, the underlying rationale with regard to changes in ownership - is the same for both sets of rules.

232. Indeed, the EC itself has confirmed the relevance of the State Aids Code to the application of its own countervailing duty law. In particular, in its recently issued regulations implementing its countervailing duty law, the EC uses the State Aids Code as a guide. There, in addressing the issue of when government provision of equity capital confers a "benefit," the EC expressly states that it will "tak[e] account of the Commission's practice as regards State aid policy in this area" when determining whether a "benefit" exists.[417]

233. Under these circumstances, it is disingenuous for the EC to argue before this Panel in favor of a rule that an arm's length, fair market value transaction extinguishes prior subsidies when that argument is directly contrary to its own settled practice under the State Aids Code.

[415] OJ C 283/02, 19.09.97., para. 1.1.
[416] Ibid., paras. 2.3 and 2.4.
[417] EC Countervailing Duty Regulations, OJ C 394, 17.12.98, pp. 10-11.

2. *USDOC did not Violate Article 19.4 of the SCM Agreement because it did not Levy Countervailing Duties in Excess of the Amount of the Subsidy*

234. The EC's one other challenge to USDOC's determinations is based on Article 19.4 of the SCM Agreement. Here, the EC explains that Article 19.4 requires that the investigating authority not impose a countervailing duty "in excess of the amount of the subsidy found to exist." The EC adds that other provisions provide contextual support for this requirement, including Article 19.1 and Articles 21.1 and 21.2. The EC then states that the only way to determine if the countervailing duty is in excess of the subsidy found to exist is to measure the Article 1.1(b) subsidy benefit, as is contemplated by Article 14. Then, insisting that the appropriate measurement is made as of the time of a change in ownership, the EC asserts that an arm's length, fair market value change-in-ownership transaction eliminates the entire amount of the subsidy benefit. In the EC's words,

> a private purchaser of a company or productive assets thereof at fair market value obtains no benefit from subsidies granted to the seller. Any benefit stream established for the purposes of allocating the benefit granted *to the previous owner* ceases to apply. Put differently, consistent with the market benchmark established in Article 14 [of the SCM Agreement], the price paid in an arm's-length transaction is equal to the fair market value. Hence, the "amount of the subsidy" is zero, and, self-evidently, there can be no "subsidization per unit" of the product under investigation.[418]

235. This argument is essentially the same as the EC's Article 10 argument above, where the EC contends that there is a requirement that the investigating authority *identify* a continuing benefit under Article 1.1(b), i.e., as of the time of the change in ownership. Here, the EC focuses on Article 14 and argues that there is a requirement that the investigating authority *measure* the benefit as of the time of the change in ownership.

236. Because the identification of the subsidy benefit and the measurement of the subsidy benefit are the same act under the benefit-to-recipient standard, much of the EC's legal support for the two arguments is the same. Thus, once again, the EC principally relies on its unsupportable view of the object and purpose of the SCM Agreement - to impose duties to offset the continuing subsidy benefit received by the firm under investigation - as the basis for measuring the subsidy benefit as of the time of the change in ownership. The United States has explained at length above in Part IV.C.1.a. that this view of the object and purpose of the SCM Agreement is erroneous, and therefore it cannot support the EC's measurement argument.

237. The EC also cites, for the first time, to Articles 21.1 and 21.2 in an effort to support its measurement argument. These provisions, however, merely provide that "[a] countervailing duty shall remain in force only as long as and to the extent necessary to counteract subsidization which is causing injury" and that inter-

[418] EC's First Submission at 41-42 (emphasis in original).

ested parties shall have the right to request that the investigating authorities to "examine whether the continued imposition of the duty is necessary to offset subsidization, whether the injury would be likely to continue or recur if the duty were removed or varied, or both." In other words, these provisions simply give interested parties, like the UK respondents in this dispute, the right to request an administrative review of the countervailing duty order. Indeed, the determinations at issue in this dispute were made by USDOC in the course of three separate administrative reviews of the countervailing duty order on UK lead bar. Through each of those administrative reviews, moreover, USDOC adjusted the countervailing duty rate applicable to UK lead bar imports, in full compliance with Articles 21.1 and 21.2. Those provisions do not require anything more of USDOC, and certainly they do not even address the measurement issue which the EC is raising here.

238. Finally, the EC cites to Article 19.1, which provides that, at the conclusion of a countervailing duty investigation finding both the existence of a subsidy and the requisite injury, the investigating authority "may impose a countervailing duty ... unless the subsidy or subsidies are withdrawn." The EC states that "no countervailing duty is needed to neutralize a withdrawn or no longer existing subsidy, and hence any countervailing duty imposed would be in excess of that allowed to offset 'subsidy.'"[419] The EC then tries to characterize an arm's length, fair market value privatization transaction as one way in which the subsidizing government could withdraw a subsidy. It opines that "[i]t is difficult to conceive of what more a government may do to withdraw a subsidy than to privatize a state-owned entity in a transparent process at arm's length for fair market value."[420]

239. As a general matter, USDOC does recognize and apply the concept of withdrawal, or repayment, of subsidies, although its approach - which does not benefit from any direct guidance in Article 19.1 - differs depending on whether a "recurring" subsidy or a "non-recurring" subsidy is at issue.

240. When addressing "recurring" subsidies, i.e., subsidies that are provided on a regular basis and that are automatic, in that each subsidy is not conditioned on prior government approval, such as an automatically available tax credit, USDOC's practice is simply to treat a subsidy as withdrawn when the government terminates the subsidy programme.

241. The concept of withdrawal is more complicated in the case of "non-recurring" subsidies, i.e., subsidies provided on an irregular basis and/or subsidies that required prior government approval for disbursement. Under USDOC's practice, as is explained above in Part III.A., paragraph 44, the benefit of a non-recurring subsidy is allocated - or, essentially, amortized - over a period of years running from the bestowal of the subsidy pursuant to a standard declining balance formula that generates a net present value equal to the amount of the subsidy. Within this context, USDOC normally considers the subsidy to have been repaid when the subsidy recipient pays the government the net present value of the re-

[419] EC's First Submission at 41.
[420] Ibid. at 41 n.88.

maining benefit stream. This approach reflects USDOC's continued adherence to a fundamental interpretation of the SCM Agreement as not contemplating any re-valuing of the subsidy benefit after it has been identified and measured (and then allocated over time) as of the time of the subsidy bestowal.

242. USDOC, of course, also recognizes the concept of withdrawal of subsidies when it applies its change-in-ownership methodology to a privatization. Indeed, in this dispute, USDOC found that a significant amount of the subsidies originally bestowed on BSC - all of which were non-recurring in nature - were withdrawn, or repaid, when BSC was privatized in 1988.

243. What it comes down to is that the EC is proposing one method for measuring the withdrawal of subsidies in the context of a privatization, and USDOC is applying another method. Nothing in Article 19.1, however, provides a basis for a panel to choose between these two methods, although it remains difficult to square the EC's proposed method with the object and purpose of the SCM Agreement.[421]

244. It is noteworthy that the EC itself, in applying its State Aids Code, does not treat an arm's length, fair market value privatization transaction as constituting the withdrawal of the subsidies previously provided to the government-owned company.[422] Rather, it treats all of the subsidies as continuing in full. In addition, in those situations where the EC does require a firm to repay a subsidy, the EC does not base the required repayment on some measurement of the then-current value of the subsidy, as is the concept underlying its proposal in this dispute with regard to privatizations. Rather, the EC requires the firm to pay the full face amount of the original subsidy, plus interest running from the date of the subsidy's bestowal.[423]

245. For all of these reasons, the Panel should reject the various arguments that the EC makes under Article 19.4.

V. CONCLUSION

246. Based on the foregoing, the United States respectfully requests the Panel to find that by imposing countervailing duties on leaded bar imports as a result of the 1994, 1995 and 1996 administrative reviews of the countervailing duty order on imports of lead bar products from the UK, the United States has not violated Articles 1.1, 10, 14 or 19.4 of the SCM Agreement, nor has the United States nullified and impaired benefits accruing to the EC under the WTO Agreements.

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[421] In this dispute, the subsidies at issue are "non-recurring" subsidies. No WTO panel (or GATT panel) has ever ruled on what might constitute withdrawal of a non-recurring subsidy, either in the context of a privatization or otherwise, and Article 19.1 certainly does not address this issue.

[422] *See* Part IV.C.1.c. *supra*.

[423] *See, e.g.*, Council Regulation (EC) No. 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty, OJ L 83, 27.3.99, at pp. 2, 6 (attached as Ex. USA-28); Notice to submit comments under Article 6(5) of the Steel Aid Code concerning the aid C 10/99 (ex NN 55/98) - Germany - Salzgitter AG, Preussag Stahl AG and iron and steel subsidiaries of the SAG group, OJ C 113/06, 24.4.99, at p. 12 (attached as Ex. USA-29).

ATTACHMENT 2.2

ORAL STATEMENT OF THE UNITED STATES
AT THE FIRST MEETING OF THE PANEL

15 June 1999

Introduction

1. Thank you, Mr. Chairman and members of the Panel. The United States appreciates this opportunity to present its views regarding the issues in this dispute.

2. In general terms, what we are talking about in this dispute is how, if at all, the SCM Agreement envisions that an investigating authority in a countervailing duty proceeding would handle the privatization of a heavily subsidized, government-owned company. Does the SCM Agreement mandate a particular approach, or does the SCM Agreement allow the investigating authority to choose from among various possible approaches?

3. Before getting into the details of this dispute, I would first like to touch upon a few of the key aspects of the EC's position. Perhaps more than anything else, these aspects highlight the flaws in the EC's position.

4. First, the EC is asking the Panel to strike down the US Department of Commerce's privatization methodology in the absence of any provision in the text of the SCM Agreement that prohibits that methodology. No provision of the SCM Agreement dictates even generally how an investigating authority is to allocate subsidies over time and across products, much less how an investigating authority is to do so in the specific case where a change in ownership occurs during the subsidy amortization period. Even if the Panel were to conclude that one or more provisions of the SCM Agreement bear *generally* on the allocation of subsidies, it is still a fact that none of those provisions prohibits the approach followed by Commerce.

5. Second, the EC is asking the Panel to strike down a methodology that is sensible, logical and reasonable. The uncontested fact is that the British Government gave £7 billion - which equals $13 billion - of subsidies benefitting the "manufacture, production or export" of steel. What Commerce did in this case was simply to offset an allocated share of those subsidies through countervailing duties on lead bar imports into the United States.

6. Third, Commerce's methodology is consistent with the object and purpose of the SCM Agreement. The SCM Agreement has as its core purpose the disciplining subsidies that are linked to "injury" (in countervailing duty proceedings under Part V) or "adverse effects" (in proceedings before the WTO under Part III). The loophole promoted by the EC - namely, the extinguishment of subsidies whenever the ownership of a subsidized company changes hands - would undercut the discipline which it is the SCM Agreement's fundamental purpose to ensure.

7. In this type of situation, Article 17.6(ii) of the Anti-Dumping Agreement, which is applicable to this dispute by virtue of the Ministerial Declaration on

Dispute Settlement, makes clear that the Panel should uphold Commerce's methodology. Specifically, Article 17.6(ii) provides that "[w]here the panel finds that a relevant provision of the Agreement admits of more than one permissible interpretation, the panel shall find the authorities' measure to be in conformity with the Agreement if it rests upon one of those permissible interpretations."

8. I would also point out, however, that the Panel's decision on the appropriate standard of review should not be determinative of the outcome of this dispute. Even if the Panel were to use the standard of review that normally applies in WTO and GATT panel proceedings, the Panel would still have to find that Commerce's methodology is not inconsistent with the provisions of the SCM Agreement on which the EC bases its challenge.

9. The final noteworthy aspect of the EC's position is that the EC would have the Panel believe that an arm's length, fair market value privatization automatically, and in all cases, extinguishes prior subsidies. However, for purposes of its own State Aids Code - which is the EC's internal analogue to the remedies authorized by the SCM Agreement - the EC takes *exactly the opposite* position. In its State Aids Code, the EC maintains that an arm's length, fair market value privatization has *no* effect on prior subsidies.

The Economics of Privatization

10. In its First Submission, the EC places considerable emphasis on what it terms the "economics of privatization" and largely ignores the ordinary meaning of the textual provisions which it invokes in this dispute.[424] Consequently, before we get into the text of the SCM Agreement, it may be helpful to take a step back and look at the practical, economic implications of what each side in this dispute is advocating. As the Panel well knows, however, regardless of the parties' economic arguments, it is the text of the SCM Agreement that must govern the Panel's decision in this dispute.

11. The entire focus of the EC's economic analysis is on who now owns the subsidized company and, specifically, whether the new owners of the subsidized company can be said to be benefitting from the deal they reached to buy the subsidized company. The EC, like the third parties, ignores the impact of the massive subsidies on the company itself - that is, the company's production facilities and how modern and efficient they are, the company's production capacity, the products that the company produces, the company's workers and the position the company has been able to achieve among its competitors as a result of government subsidization.

12. The SCM Agreement takes a different focus, as does the United States. The SCM Agreement focuses on the subsidized company and, more specifically, the subsidized company's production. Consistent with this focus, the SCM Agreement seeks to deter and offset the trade distortions that typically result when a company's production is subsidized.

[424] *See* EC First Submission at paras. 50-66.

13. From this perspective, the EC's focus on the new owners of the subsidized company is simply inadequate. It does not address the trade distortions which subsidies cause, particularly in the context of a market like steel, where the industry is heavily subsidized.

14. In this dispute, we are not talking about a sale of chairs or pencils. What is really at issue is a company - more specifically, a heavily subsidized company in a heavily subsidized industry.

15. In this type of industry, excess capacity, often brought on by the very same massive government subsidization which the EC's theory assumes away, can distort the market tremendously. Where the government provides massive subsidies to an industry, resources are misallocated. Companies are enabled to continue building and modernizing production facilities and producing output even where output exceeds demand. The resulting excess capacity and excess output drive down the value of the companies in this industry as well as the prices of the industry's overall output. These dynamics certainly call into question whether it is sound to treat an arm's length price paid for a government-owned company in a heavily subsidized industry as automatically extinguishing the considerable amount of subsidies previously bestowed upon it, as the EC wants the Panel to conclude. The original subsidies continue to distort trade, through artificially high output, through artificially low output prices resulting from the excess capacity which they created and through the reduced value of companies throughout the industry.

16. The industry at issue in this dispute well illustrates this point.

17. Plainly, government subsidization - particularly when it reaches levels like *£7 billion* in the case of British Steel - can dramatically increase the competitiveness of a steel company by financing extensive modernization of facilities and the use of the most advanced production technologies, along with whatever training of workers is necessary, among other things. The sale of that company at a fair market price does not remove the subsidy-induced distortion caused by the company's strengthened steel production capabilities.

18. Indeed, look at British Steel today. It has just purchased the Dutch company, Hoogovens, and has become not only competitive and profitable, but is now the third largest steel company in the world. This is the same company that was described as "uncompetitive" prior to the massive subsidization undertaken by the UK Government in the years leading up to British Steel's 1988 privatization.

19. Mr. Chairman, let me now address how the EC earlier in its Oral Statement refutes the United States' analysis above. The EC's refutation, in its entirety, can be found in the last sentence of paragraph 51 on page 14 of the EC's Oral Statement (page 44 of the Panel Report). That sentence reads: "The claim that a subsidy (always?) results in lowered market prices, higher output, reduced value for companies, and ultimately survival of firms that would otherwise have failed is false." That's it, Mr. Chairman. The EC does not say anything other than that the United States' analysis is "false."

20. Meanwhile, if we look at the EC's own Guidelines for the Calculation of the Amount of Subsidy in Countervailing Duty Investigations (which is Exhibit

USA-14), in paragraph D, we find that it contradicts the EC's position here. It states that, in its regulations, the EC "assumes that an important effect of a subsidy is always to reduce a firm's costs ... ."

21. Mr. Chairman, I would also like to briefly address the new exhibit which the EC attaches to its Oral Statement, Exhibit EC-13, a short article written by Professor Cooper. I have not seen this article before this morning, and I have only had a chance to peruse it quickly. However, I would like to make a few preliminary comments about it. First, if you turn to page 3 of Professor Cooper's article and look at the third full paragraph, you will see that Professor Cooper admits that he is not looking at the privatization issue from a legal perspective; rather, he is only providing an economic analysis. And, if you look at the rest of the article, as I have done rather quickly, I believe that you will not find any mention whatsoever of any provisions of the SCM Agreement or what the SCM Agreement requires as a legal matter. It may be for this reason that the article does not address in any way the economics of privatization from the economic perspective that is consistent with the object and purpose of the SCM Agreement. In this regard, although I have only been able to read through the article quickly, I have found no references to or discussions of the trade distortions caused by subsidization.

The Text of the SCM Agreement

The EC's Claim Under Article 10

22. Turning to the actual text of the SCM Agreement, let's look at the EC's principal claim, which invokes Article 10. Here, the EC is arguing that Commerce did not "take all necessary steps" to ensure that its imposition of countervailing duties conformed to the requirements of the SCM Agreement. The specific requirement that Commerce allegedly failed to follow is the Article 1 requirement of identifying a subsidy "benefit".

23. In looking at this claim, it is useful first to clarify what is and what is not in dispute.

24. First, the EC does not dispute that Commerce acted consistently with Article 1 when it began its analysis by *identifying* the elements of a subsidy - a "financial contribution" and a "benefit" - for each of the subsidies at issue, as of the time of their bestowal.

25. Second, the EC does not dispute that Commerce acted consistently with Article 14 when it next *measured* the subsidy benefits based on the circumstances prevailing as of the time of the subsidy bestowals.

26. Third, the EC does not dispute that Commerce acted consistently with the SCM Agreement when it then *allocated* the measured subsidy benefits over a period of 18 years, which is the average useful life of assets for British Steel.

27. What the EC does dispute is Commerce's refusal to re-visit the determination identifying the subsidy "benefit." The EC maintains that Article 1 requires - not *permits*, but rather *requires* - the investigating authority to identify the subsidy "benefit" not just as of the time of the subsidy bestowal, but also as of the time when the ownership of the subsidized company changed hands.

28. On this issue, however, the SCM Agreement is *silent*. The SCM Agreement does not address *how* an investigating authority should take into account a change in the ownership of the subsidized company. Indeed, the SCM Agreement does not even expressly address *whether* the investigating authority should take into account a change in the ownership of the subsidized company in the first place.

29. In fact, the text of the SCM Agreement suggests that none of this type of analysis is required. As the United States explains at length in its First Submission, the text of Article 1 of the SCM Agreement envisions that the investigating authority will identify the subsidy "benefit" as of the time of the subsidy bestowal. The text of Article 1 is concerned with, and requires the identification of, the "benefit" that is conferred at the time when the government provides the "financial contribution." Beyond that, the text of Article 1 is silent. It certainly does not address specifically what an investigating authority should do when confronted with the privatization of the subsidized company.

30. Article 14, meanwhile, provides relevant context for interpreting Article 1, as Article 14 addresses the measurement of the subsidy "benefit."

31. The text of Article 14 supports the United States' interpretation of Article 1. As the text of Article 14 shows in a very straightforward way, Article 14 looks only to the time of the subsidy bestowal, and not to any subsequent point in time, for the measurement of the subsidy "benefit."

32. Furthermore, there is one place in the SCM Agreement where a provision addresses the privatization issue, and that is in Article 27.13. While Article 27.13 by its terms only applies to WTO proceedings under Part III against developing country Members, it still provides context for interpreting Article 1 and how Article 1 is applied in countervailing duty proceedings under Part V, given that Article 1 itself is applicable in proceedings under both Part III and Part V.

33. Article 27.13 reflects the general rule contemplated by the SCM Agreement, which is that subsidies bestowed on a government-owned company's production prior to privatization normally *are* actionable after privatization.

34. Article 27.13 squarely contradicts the EC's stated position in this dispute that, under Article 1, previously bestowed subsidies are extinguished by a privatization transaction. Indeed, if the EC's position were accepted, it would render Article 27.13 wholly *superfluous*. In other words, if Article 1 really meant that a privatization transaction automatically eliminated any continuing subsidy "benefit," there would be no need for Article 27.13 to say, as it does, that certain pre-privatization subsidies do not remain actionable after privatization.

35. Mr. Chairman, in its Oral Statement this morning, the EC says that Article 27.13 is not relevant because it only applies to new subsidies, granted as part of the privatization transaction itself, and not to subsidies granted prior to privatization. The United States disagrees with this interpretation of Article 27.13, as the language shows that it applies to subsidies granted prior to privatization. I would note that Brazil in its Third Party Submission at paragraphs 83-86 agrees with the United States on this point, although Brazil does go on and attempts to distinguish Article 27.13 on a different ground. For now, we will simply let the Panel read the language of Article 27.13 itself.

36. So, the obvious question that arises at this point is, on what precisely does the EC base its position that Article 1 *requires* the investigating authority to identify the subsidy "benefit" as of the time when the ownership of the subsidized company changed hands? The answer is not found in the *text* of Article 1 or in the *context* provided by Article 14. The EC relies instead on what it views as the *object and purpose* of the SCM Agreement. That is the foundation of the EC's argument.

37. As a preliminary matter, it is difficult to imagine how a Panel could ever be expected to identify a specific, methodological requirement in the SCM Agreement - perhaps in any WTO agreement - based almost entirely on the agreement's object and purpose, as interpreted by a Member. But, that is what the EC is attempting to do here.

38. In any event, the EC basically is arguing that the object and purpose of the SCM Agreement demonstrates a concern with the subsidized company and, in particular, the current owners of the subsidized company and how they are affected by the subsidy. From this concern, the EC extrapolates to a *requirement* that the investigating authority identify a current subsidy "benefit" to these owners. In the privatization context, this means that the investigating authority would have to identify a current "benefit" to the new owners of the government-owned company, i.e., the owners of the successor, privatized company.[425]

39. As we explain in our First Submission, the EC's reliance on the object and purpose of the SCM Agreement fails for two basic reasons.

40. First, as the panel recently held in the *Canadian Civilian Aircraft* case, it is unwise to rely heavily on the object and purpose of the SCM Agreement to support the interpretation of a particular provision of the SCM Agreement, given the absence of any express statements in the SCM Agreement setting forth its object and purpose. This admonition is especially appropriate in this dispute. Here, the EC uses its interpretation of the SCM Agreement's object and purpose as the basic support for its challenge; it is not simply using it, as is normally the case, as a supplement to textual and contextual interpretations of particular terms.

41. The second defect in the EC's argument is that the EC reads into the SCM Agreement an object and purpose that is not supported by the text of the SCM Agreement, even at its most basic level.

42. The EC is mistaken, in particular, because the SCM Agreement does not focus on the current *owners* of the subsidized company and how they are being affected by the subsidy. Rather, the SCM Agreement focuses on the *merchandise* and, in particular, on subsidies bestowed on the manufacture, production or export of the merchandise. It is with this focus that the SCM Agreement sets out to deter and offset trade-distorting government subsidies benefitting merchandise and causing injury to an industry in the importing country.

[425] *See* EC First Submission at 29-32, 34, 37-39.

43. Given the SCM Agreement's silence on the basic issue before the Panel, Commerce had to develop its own methodology. We explained this methodology in detail in our First Submission,[426] and I will not repeat it here.

44. The basic point is that Commerce developed a methodology that is sensible and well-reasoned.

45. To begin with, this methodology does not wholly ignore a change in ownership. Indeed, it takes it into account. The EC seeks a rule that requires an examination of whether there is a continuing "benefit" to the new owners at the time of the change in ownership. However, Article 1 simply cannot be read as requiring this type of examination. Commerce reasonably decided to take a change in ownership into account through the way in which it allocates the prior subsidies over time.

46. Commerce's approach is also reasonable because it pays particular attention to the facts of each case. As a consequence, Commerce's approach can result in either a small percentage or a large percentage of the prior subsidies being apportioned to the successor company, depending on the facts. In this dispute, for example, Commerce apportioned only 57 per cent of the prior subsidies to the successor company in the first of the three change-in-ownership transactions at issue. I would note also that, again depending on the facts, Commerce's approach can even come up with the result sought by the EC in this dispute, which is to have *none* of the prior subsidies apportioned to the successor company. Commerce recently ended up with this result in an investigation of stainless steel sheet and strip from France, where the transaction at issue was Usinor's 1994 sale of Centrale Sidérurgique de Richemont.[427]

47. Furthermore, as we explain in our First Submission,[428] Commerce's approach is well-grounded in fundamental principles of the SCM Agreement, particularly those found in Articles 1 and 14.

48. Commerce's approach also displays a sound economic concern for the trade distortions that subsidization can cause.

49. Beyond these considerations, it can also be seen that the methodology developed by Commerce does not conflict with any provisions of the SCM Agreement raised by the EC in this dispute. Indeed, it does not conflict with any provisions of the SCM Agreement at all.

50. We would also note, as well, that Commerce's methodology is consistent with the object and purpose of the SCM Agreement, as it seeks to remedy the trade distortions that subsidization can cause.

51. Under these circumstances, Commerce's methodology for handling the pre-privatization subsidies at issue in this dispute cannot be considered to be in violation of Articles 1, 10 or 14 of the SCM Agreement.

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[426] *See* US First Submission at paras. 36-62.

[427] The cite for this determination is *Final Affirmative Countervailing Duty Determination; Stainless Steel Sheet and Strip in Coils from France*, 64 Fed. Reg. 30774 (8 June 1999) (attached as Exhibit USA-30).

[428] *See* US First Submission at paras. 147-61.

The EC's Claim Under Article 19.4

52. The EC's other claim in this dispute is very similar to its first claim. Instead of focusing on how Commerce *identified* the subsidy "benefit" under Article 1, the EC invokes Article 19.4 and addresses Commerce's *measurement* of the subsidy "benefit." Here, the EC is arguing that, just like Article 1, Article 14 *requires* the investigating authority to measure the subsidy "benefit" as of the time of a privatization, not just as of the time of the subsidy bestowal.

53. This argument is not new, and it fails for essentially the same reasons as does the EC's first claim.

54. The EC does, however, raise one new concept when it cites to Article 19.1 and then argues that an investigating authority may not impose a countervailing duty if a subsidy has been "withdrawn." The EC's ultimate point is that an arm's length, fair market value privatization transaction constitutes the withdrawal of all previously bestowed subsidies.

55. We address this argument in some detail in our First Submission.[429] The fundamental point that we make is that Article 19.1 does not explain what it means by the term "withdrawn" or how a withdrawal of subsidies should be measured, either generally or in the privatization context. Indeed, Article 19.1 does not even indicate that there is any withdrawal of subsidies that takes place in a privatization transaction.

56. Commerce, of course, does recognize and apply the concept of withdrawal in the privatization context. The EC's complaint is that Commerce does not apply this concept in the way that the EC wants Commerce to. But, that is no basis for finding a violation of Article 19.1, given that Article 19.1, again, does not even indicate that there is any withdrawal of subsidies that takes place in a privatization transaction, and it certainly does not address how any withdrawal of subsidies should be measured.

Standard of Review

57. In terms of the applicable standard of review, which, in the United States' view, is the standard of review set forth in Article 17.6 of the WTO Anti-Dumping Agreement, Commerce's methodology certainly represents a "permissible" interpretation of the SCM Agreement.

58. Given that the SCM Agreement is silent, even after giving its terms their ordinary meaning in their context and in light of the SCM Agreement's object and purpose, Commerce came up with a "permissible" interpretation of the SCM Agreement. It did this by developing a methodology that is sensible and well-reasoned, grounded in fundamental SCM Agreement principles, not in conflict with any provisions of the SCM Agreement, and consistent with the SCM Agreement's object and purpose.

[429] *See* US First Submission at paras. 238-44.

59. As the Panel is aware, however, the third parties in their First Submissions do not agree that Article 17.6 provides the relevant standard of review, even though the Ministerial Declaration on Dispute Settlement states "the need for consistent resolution of disputes arising from anti-dumping and countervailing duty measures." The third parties argue that the Declaration has no effect on what the standard of review should be in SCM Agreement disputes.

60. The United States submits that it cannot be correct to interpret the Declaration as being meaningless, as do the third parties. It must have some meaning. In the United States' view, Members were aware of the many similarities between the anti-dumping proceedings and the countervailing duty proceedings that a panel would be reviewing, and they did not want inconsistent resolutions for disputes under the Anti-Dumping Agreement and the SCM Agreement simply because of the use of different standards of review. The import of the Declaration is that a panel should use the Anti-Dumping Agreement's standard of review when reviewing a countervailing duty proceeding.

61. Nevertheless, the United States also submits that the Panel's decision on the appropriate standard of review should not be determinative of the outcome of this dispute. Regardless of whether the Panel were to use the Article 17.6 standard of review or the standard of review found in GATT panel cases deciding anti-dumping and countervailing duty disputes prior to the specification of a standard of review in the WTO Anti-Dumping Agreement, the Panel would still have to find that the EC has not carried its burden of showing a violation of the SCM Agreement.

62. In GATT panel cases, when the panel has found a provision to be silent about a certain matter after giving its terms their ordinary meaning in their context and in light of the relevant agreement's object and purpose, the panel has taken one of two approaches. In a case like *United States Salmon*, once the panel determined that the agreement did not address whether a particular subsidy calculation adjustment should be made, it stopped its analysis and found the challenged approach to be not inconsistent with the agreement. The panel also followed the same approach after finding that the agreement did not specify a methodology for calculating the amount of the subsidy.[430] In *New Zealand Electrical Transformers*, the panel took a slightly different approach. After concluding that the agreement was silent because it did not provide any specific guidelines for the calculation of the cost of production in an anti-dumping case, the panel stated that "the method used in this particular case appeared to be a reasonable one," and it therefore found no violation of the agreement.[431]

[430] The relevant part of the *United States Salmon* panel report is found in *United States - Imposition of Countervailing Duties on Imports of Fresh and Chilled Atlantic Salmon from Norway*, SCM/153, Report of the Panel (unadopted), dated 4 December 1992, at paras. 243-46 and 247-49.

[431] The relevant part of the *New Zealand Electrical Transformers* panel report is found in *New Zealand - Imports of Electrical Transformers from Finland*, L/5814, Report of the Panel, adopted on 18 July 1985, 32/S55, 66-67, at paras. 4.2-4.3.

63. Under either of these pre-WTO formulations of the standard of review, we submit that Commerce's determinations in this dispute are not inconsistent with any provision of the SCM Agreement.

The EC's Own Contrary Practice

64. There is one other matter that needs to be addressed to put this dispute in proper perspective, and that is the EC's own practice.

65. The question that arises is, why does the EC, in its own practice, not follow the approach that it is advocating before the Panel in this dispute? Here, I am not just talking about the EC's internal anti-subsidy law, its State Aids Code. I am also talking about the EC's countervailing duty law.

66. But, let's first look at the EC's State Aids Code. Under this law, the EC internally regulates member State subsidization. In other words, it focuses on the subsidization of firms within and among the member States that comprise the EC's single market. This law is quite similar to the EC's countervailing duty law. It is similarly founded on a general recognition of the "distortive effect" of State aid and how this distortive effect "is magnified as other government-induced distortions are eliminated and markets become more open and integrated."[432] The EC even uses this law, the State Aids Code, as a guide when applying its countervailing duty law.[433]

67. So, how does the State Aids Code handle privatizations? It takes an approach that is *exactly the opposite* of what the EC is advocating in this dispute. It does *not* treat an arm's length, fair market value change-in-ownership transaction as extinguishing prior subsidies. To the contrary, it treats the prior subsidies as automatically continuing, in full, to the benefit of the successor company.

68. Thus, while the EC argues in this dispute that no rational person could disagree with its position that, as an economic mater, an arm's length, fair market value privatization transaction extinguishes all prior subsidies, DG-IV of the European Commission plainly does disagree with that position.

69. Now, let's turn to the EC's countervailing duty law. What can we see from an examination of this law?

70. First of all, when this law seeks to identify the subsidy "benefit," it looks only at events as of the time of the bestowal of the subsidy. The EC has no provision that ever calls for a current "benefit" test. In other words, it does not ever look at events *subsequent to* the subsidy bestowal and attempt to determine, as of that time, whether there is a *continuing* benefit from the subsidy, even though that is what the EC is advocating in this dispute.

71. It is true that the EC's countervailing duty law does not address how a privatization might or might not affect previously bestowed subsidies. It is simi-

[432] *See* EC Guidelines for State Aid for Rescuing and Restructuring Firms in Difficulty, OJ C 283/02, 19.09.97, paras. 1.1, 2.3 and 2.4 (Exhibit USA-27).
[433] *See* EC Countervailing Duty Regulations, OJ C 394, 17.12.98, pp. 10-11 (Exhibit USA-14).

lar to the SCM Agreement in this regard. But, it is noteworthy that the EC has, in fact, deliberated about what would be an appropriate rule for handling pre-privatization subsidies.

72. During our consultations in this dispute, the EC mentioned that it was considering a draft regulation on privatization, although the EC did not then provide us with a copy of that draft regulation.

73. We now have a copy of that draft regulation. It was recently submitted to us by the US steel industry in response to a request for public comments on this dispute.

74. The draft regulation at issue can be found in paragraph (h) of Section D of a Draft Communication from the European Commission, dated 3 January 1998, and entitled "Calculation of the amount of subsidy in countervailing duty investigations." The United States is submitting a copy of this Draft Communication as Exhibit USA-31.

75. Paragraph (h) begins by stating a general rule. It says:

> If the privatization is carried out by means of an open market sale to the highest bidder, any subsidies granted to the company before privatization should be extinguished by such a transaction.

That is clear enough. But, paragraph (h) then proceeds to make an exception for certain types of subsidies, which would not be extinguished by a privatization. Here, looking at the subsidies granted to the company before privatization, paragraph (h) says: "[S]ubsidies which relieve the new owners of normally inherited obligations ... would still benefit the privatized company." Paragraph (h) gives one example of the types of subsidies that would fall into this category, and that example is "the forgiveness of debts".

76. So, what does all of this mean? It means that DG-I of the European Commission, during the pendency of this dispute, was considering a proposed regulation that did *not* treat all previously bestowed subsidies as extinguished by an arm's length, fair market value privatization transaction.

77. It also means that, at a minimum, this draft regulation reflects a view held by some within the EC that the SCM Agreement does *not* require the approach that it is advocating in this dispute - namely, that all previously bestowed subsidies are extinguished by an arm's length, fair market value privatization transaction. It would seem to be the view of the authors of paragraph (h) that the SCM Agreement allows the investigating authority flexibility in determining how to handle pre-privatization subsidies and does not dictate any particular approach.

78. Thus, again, while the EC argues in this dispute that no rational person could disagree with its position that an arm's length, fair market value privatization transaction extinguishes all prior subsidies, apparently some persons in DG-I of the European Commission did, and perhaps still do, disagree with that position.

79. I would note that the EC did not include paragraph (h) - or any other regulation addressing privatization - in the final countervailing duty regulations which it issued in December of last year. This raises one further question. Why did the EC not include a final regulation that simply stated its position in this

dispute - namely, that an arm's length, fair market value privatization extinguishes all of the prior subsidies - given that, according to the EC, the SCM Agreement requires this approach?

Policy Considerations

80. Finally, because the EC makes an issue of it in its First Submission, it may also be helpful to take a step back and examine the policy implications of each of the privatization approaches advocated by the parties in this dispute. Again, however, we would first emphasize that it is the text of the SCM Agreement that must govern the Panel's decision in this dispute.

81. The EC's approach to privatization basically calls for the extinguishment of all prior subsidies - whether they were bestowed ten years before or only one year before privatization, and regardless of whether those subsidies totaled £700 or £7 billion. What government policies are being encouraged by this approach, and what government policies are being discouraged by this approach?

82. We submit that, in the world the EC wants the Panel to create, governments would be encouraged to *subsidize*. Indeed, particularly where a government may be contemplating an eventual sale of a government-owned company, the government could pour massive subsidies into that company to make it one of the most modern and efficient companies in the industry, safe in the knowledge that all of those subsidies - even if they totaled more than £7 billion - would simply vanish as a legal matter once the company was sold.

83. Now, let's look at the United States' approach to privatization. Under this approach, the successor to the government-owned company does retain some of the countervailing duty liability that originally resided with the government-owned company, but at the same time a significant portion of the countervailing duty liability is also treated as extinguished. What is being encouraged and discouraged by this approach?

84. Here, governments are being encouraged to *privatize*, not *subsidize*. Through a privatization, a government can get rid of a portion of the countervailing duty liability generated by its past subsidization of a government-owned company; therefore, there is an incentive for the government to privatize. At the same time, this approach does not encourage further subsidization. If the government were to try to turn the government-owned company into a more modern and efficient company through massive subsidization, the government would only be increasing the countervailing duty liability of the successor company.

85. So, which of these competing approaches is consistent with the object and purpose of the SCM Agreement? I would submit that a *detailed* statement of the object and purpose of the SCM Agreement might be difficult to agree on. But, certainly, at its most basic level the object and purpose of the SCM Agreement is to *discourage* subsidization, like the United States' approach, not to *encourage* subsidization, as would be the result under the EC's approach.

Observations Regarding the Third Parties' Submissions

86. The third party submissions of Brazil and Mexico both attempt to support the EC's view that Article 1 of the SCM Agreement requires the investigating authority to identify a subsidy "benefit" as of the time when the ownership of the subsidized company changed hands. In fact, however, their attempts at providing support only serve to reinforce the fact that Article 1 does not address this issue.

87. As can be seen from their submissions, Brazil and Mexico interpret what is required by Article 1 differently, and their conflicting interpretations are also different from the EC's interpretation. In other words, between them, the EC, Brazil and Mexico come up with three different interpretations of Article 1.

88. What is common to all of these interpretations is that they are not supported by the terms of Article 1 when given their ordinary meaning in their context and in light of the SCM Agreement's object and purpose.

89. As is discussed above, the EC seems to interpret Article 1 as meaning that the investigating authority must identify a "benefit" as of the time of the subsidy bestowal and, also, as of the time when the ownership of the subsidized company changed hands.

90. Brazil argues, however, that the investigating authority is to identify the "benefit" only once, during the period of investigation.[434]

91. Mexico asserts that the investigating authority is to identify the "benefit" at least on three occasions, and possibly four. Here, Mexico refers to the initiation of the investigation, the preliminary determination and the final determination, and it adds that a "benefit" also must be identified in a review of the countervailing duty order.[435]

92. If nothing else, these divergent interpretations show that the EC, Brazil and Mexico are attempting to read into Article 1 what is not there.

93. As the United States has shown in its First Submission, Article 1 is silent when it comes to changes in ownership. Neither Article 1, nor any other provision of the SCM Agreement, addresses whether and, if so, how the investigating authority should take into account a change in ownership of the subsidized company.

Observations Regarding the EC's Oral Statement

94. Mr. Chairman, I would now like to make just a few more observations regarding the EC's Oral Statement.

95. At one point, the EC addresses certain decisions of US courts which the United States discusses in its First Submission. The EC says that the Panel should not consider them when reaching its decision in this dispute. In our First Submission, we simply point out that these court decisions are interpreting a counter-

[434] *See* Brazil Third Party Submission at para. 42.
[435] *See* Mexico Third Party Submission at para. 9-10.

vailing duty law - the United States' countervailing duty law - which is not materially different from the SCM Agreement with regard to any of the provisions at issue in this dispute. That is why those decisions may be useful to the Panel. But, the Panel still should come up with its own independent decision interpreting the provisions relevant to this dispute.

96. The EC also questions the relevance of the United States' citations to decisions of the US Department of Commerce. Let me state that the United States does not cite Commerce's own decisions as basis for showing how the SCM Agreement should be interpreted. Rather, the United States describes those decisions to establish, as a matter of fact, what Commerce's privatization methodology is. As it turns out in this dispute, it is especially important that we did so because the EC mischaracterizes that methodology repeatedly in its First Submission and again in its Oral Statement.

97. One example is that the EC continues to make negative references to Commerce's privatization methodology because, in the EC's words, this methodology uses an "irrebuttable presumption" that the previously bestowed subsidies pass through to the successor company.

98. On this point, the EC fundamentally misunderstands Commerce's privatization methodology. As the United States has established as a matter of fact in its First Submission,[436] Commerce's privatization methodology does not use an "irrebuttable presumption". It is a different methodology - Commerce's normal methodology for allocating non-recurring subsidies over time - which uses an "irrebuttable presumption". And, in this regard, Commerce's allocation methodology is no different from the allocation methodologies used by the EC and other Members and endorsed by the Informal Group of Experts. Like Commerce, all of these entities treat non-recurring subsidies as automatically benefitting the subsidized merchandise for a period of years. Indeed, the EC's own countervailing duty regulations expressly state that the EC has "assumed" this automatic benefit.[437]

99. In contrast, Commerce's privatization methodology plainly does not make an "irrebuttable presumption" that the previously bestowed subsidies pass through to the successor company. As we have already explained, Commerce's privatization methodology is dependent on the facts of the particular case, and normally it results in the apportionment of only a percentage of those subsidies to the successor company. In some circumstances, moreover, the facts dictate that *none* of the subsidies be apportioned to the successor company, as recently happened in a countervailing duty investigation of stainless steel sheet and strip from France.

100. Thus, the Panel should view the EC's repeated references to a non-existent "irrebuttable presumption" as no more than an attempt - an unsupportable attempt - to make Commerce's privatization methodology appear as though it is somehow unreasonable.

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[436] *See* US First Submission at paras. 85-86 and 143-45.
[437] *See* EC Countervailing Duty Regulations, OJ C 394, 17.12.98, p. 12 (Exhibit USA-14).

Summary

101. In summary, the United States believes that the US Department of Commerce handled a situation not addressed by the SCM Agreement in a sound and well-reasoned manner, and there is no basis for the Panel to find that Commerce acted in any way that was inconsistent with the SCM Agreement.

Conclusion

102. Mr. Chairman, that concludes my presentation. The United States looks forward to answering any questions that the Panel may have.

ATTACHMENT 2.3

RESPONSES OF THE UNITED STATES TO QUESTIONS FROM THE PANEL AT THE FIRST MEETING WITH THE PANEL

30 June 1999

QUESTIONS FOR BOTH PARTIES

Q.1. If a new rate of subsidization is being established in the course of a review (either under Article 19 or Article 21 of the SCM), according to data for the relevant period of review (POR), are parties of the view that this involves determining whether subsidization continued over the POR? Or could a new rate of subsidization be determined without establishing whether subsidization continued?

1. The United States is of the view that authorities must determine whether subsidization continues during each POR and makes this determination for each POR. Such a determination does not entail re-valuing the benefit from past subsidies. Among the many factors that could change the rate of subsidization in a review are the following:

2. First, there could be new subsidy programmes, which could provide new non-recurring or recurring subsidies. The new non-recurring subsidies would have to be identified, valued and allocated for the first time, and that portion of the countervailable benefit under such programmes allocable to the period of review would be distributed over either the production of subject merchandise during that period (in the case of a domestic subsidy) or exports of the subject merchandise during that period (in the case of an export subsidy). In the case of a new recurring subsidy, the entire benefit granted during the period of review would be "expensed" during the review period, that is, allocated over either the total production or exports of the subject merchandise during the period of review.

3. Second, the level of benefit in a recurring subsidies programme could change. For example, a programme that initially granted the producer $1 for every unit exported could be changed to grant the producer $2 for every unit exported. This change would be accounted for in the review.

4. Third, for non-recurring subsidies, that portion of the benefit from the original financial contribution allocable to the period of review must be determined. Under the US methodology, this amount declines each year. Under the EC methodology, this amount remains constant for each year. Where the CVD order covers a number of subsidy programmes, the amortization of one or more subsidies could expire during the period of review, terminating CVD liability for subsidies under that programme.

5. Fourth, all of the recurring and non-recurring subsidies allocated to the period of review must be divided over the production of the subject merchandise during that period (in the case of domestic subsidies) or the total exports of the subject merchandise during that period (in the case of export subsidies). The *ad*

valorem rate of subsidization will increase or decrease in inverse proportion to the total amount of production or exports over which each subsidy is allocated.

6. Fifth, new exporters could have shipments during the review period that would have to be reviewed. The level of subsidies these exporters received could differ from that of the other exporters.

7. All of these examples involve determining the extent to which recurring subsidies are paid during the review period, or to which the benefits from either past (and, therefore, previously valued) or new non-recurring subsidies are allocable to the POR and attributable to the exports covered by the review. In the case of non-recurring subsidies, like all of those provided to British Steel, USDOC does *not* look at events occurring during the POR to determine whether the subsidy recipient received a "benefit" within the meaning of Article 1.1 that is countervailable, unless the particular subsidy at issue was provided during the POR. Rather, USDOC looks only at the time of the subsidy bestowal to determine whether the requisite "benefit" exists.

8. For example, if two subsidies had been found in the original investigation ten years before the POR, one non-recurring and the other recurring, the non-recurring subsidy had been allocated over nine years, and the recurring subsidy discontinued, no subsidization would be found in the POR. This finding that subsidization did not continue would *not* entail re-determining the amount of the benefit from the original non-recurring subsidy. The amount of the benefit for non-recurring subsidies is determined at the time such subsidies are bestowed. Once the amount of the benefit (and its specificity) have been established, the Agreement permits that benefit to be amortized over time without any reevaluation. The EC's practice recognizes this principle.

Q.2. Are parties of the view that establishing whether subsidization continued over the POR involves looking into whether a financial contribution conferring a benefit took place over the POR? Or could one establish the existence of subsidization during the POR without assessing whether a financial contribution conferring a benefit was made during the same period?

9. The United States is of the view that, in order to establish whether subsidization continued over the POR, authorities must determine that a benefit conferred by a financial contribution is allocable to the POR. However, the United States does not believe that the financial contribution must have been made during the POR. A financial contribution conferring a benefit may have been made for a non-recurring subsidy many years before the POR, with that benefit being amortized over a period that includes the POR.

10. When dealing with non-recurring subsidies, such as large grants or equity infusions that occur only once and that benefit the production or export of merchandise over time, it is not necessary to find a physical disbursement of funds, or an administrative or legislative decision to forego revenue, in each year of the benefit stream in order to determine that a financial contribution and a benefit exist. In fact, for most large non-recurring subsidies, it is unusual for there to be any government action at all throughout the life of the benefit stream, once the decision to bestow the subsidy has been taken. However, this does not mean that

there is no financial contribution, within the meaning of Article 1.1, in each year of the benefit stream. If a government gave $1 million to the widget industry, and the average useful life of assets in the widget industry was 10 years, the United States considers that it is appropriate for authorities to find that a financial contribution and a benefit exist in each of those 10 years, even though the physical act of disbursement occurred only once - in year one. To our knowledge, all authorities that impose countervailing measures, including the EC, consider that a financial contribution and a benefit exist for non-recurring subsidies in each year of the benefit stream, regardless of whether an actual physical disbursement of funds or decision to forego revenue takes place in each of those years.

11. In the case of recurring subsidies, a one-time-event approach is more logical. For example, in the case of a tax credit that is given each year on a continuing basis, authorities would look to see whether the single act of disbursement, or the single decision to forego revenue, took place during the POR. For example, if a tax credit were granted in each of the first four years after an investigation, authorities could find a financial contribution and a benefit in each of the first four PORs. If that tax credit was not granted in the fifth POR, authorities should find no financial contribution and, consequently, no benefit, in that POR.

12. The United States is also of the view that authorities must determine whether there is a benefit in the POR. When we say (as in para.119 of the US First Submission) that Article 1.1 does not require a determination that there is any *continuing benefit* after the subsidy bestowal, we mean that there is no requirement that authorities assess the continuing economic effects of a subsidy, such as in the form of increased output or lower prices, on a company's production from year to year after the subsidy has been bestowed. To our knowledge, no authorities that impose countervailing measures, including the EC, assess the continuing economic effects of subsidies before imposing duties. It is the view of the United States that assessing the continuing benefit of a subsidy on the subsidized company or subsidized productive units constitutes assessing the continuing economic effects of a subsidy. The SCM Agreement embodies the presumption that subsidy benefits continue over time and thus does not require the annual (or episodic) reassessment of whether the effect of the original benefit may have been augmented or diminished by subsequent events.

13. When we say (as in para. 118 of the US First Submission) that the identification and measurement of a subsidy will be made only once, as of the time of the subsidy bestowal, we mean that a subsidy is analysed as of the time that it is bestowed. Article 1 of the SCM Agreement states that a "...subsidy shall be deemed to exist..." if there is a financial contribution and "... a benefit is thereby conferred." Article 1 contemplates that the existence of a "benefit" will be determined on the basis of market-based benchmarks. Article 14 provides that a "benefit" will be measured on the basis of such benchmarks. Articles 1 and 14 presume that the identification of a subsidy and the measurement of the benefit refer back to the time of bestowal. A grant received in 1988 is presumed to exist as of 1988, when the money is actually received.

14. With respect to long-term subsidies, the benefit stream - i.e., the number of years over which a subsidy is allocated *and* the fraction of the total benefit to be offset in each year of that allocation period - is dictated by the terms and con-

ditions that prevail in the year of bestowal of the subsidy. For example, a 10-year, fixed-rate loan received in 1988 would have a benefit stream consisting of a 10-year allocation period and, in each of those 10 years, a fraction of the total interest savings over the 10-year period that would be calculated by reference to the interest differential between the government rate and the market benchmark prevailing in 1988. Any changes in the spread between the government rate and the market benchmark that might occur after 1988 would have no effect on the benefit stream calculated with respect to the 1988 long-term loan. Similarly, an equity infusion received in 1988 would be evaluated by reference to the usual investment practices of private investors prevailing in 1988. Even though market conditions may change after 1988, and private investors might find investment in a particular industry more or less attractive than they did in 1988, such changes would have no effect on the calculation of the benefit stream. In both of these instances, the identification of the subsidy and measurement of the benefit must be performed by reference to the date of bestowal. Otherwise, the provisions of Articles 1 and 14 would be rendered meaningless.

15. None of this is to say that investigating authorities do not need to determine whether there is a benefit in the POR. Clearly, the legal requirements of Article 1, including financial contribution, benefit, and specificity, must be met in each POR. By referring to the benefit stream originally calculated with reference to benchmarks prevailing in the year of the subsidy bestowal, allocating a portion to subsequent years, including the POR, calculating the per unit subsidy amount based on production or exports during the POR, and taking into account other changes required by the SCM, such as whether a subsidy has been withdrawn by being repaid, the United States is of the view that investigating authorities do in fact determine whether there is a benefit in the POR.

QUESTIONS TO THE UNITED STATES

Q.1. Is the US of the view that verifying the existence of benefits during the POR merely requires (a) valuing the subsidy at the time of bestowal, and (b) deciding on an appropriate method to amortize the subsidy over time?

16. Generally, yes. All that the SCM Agreement requires is for the investigating authority to identify and measure a subsidy "benefit" within the meaning of Article 1.1 as of the time when the "financial contribution" was made or, in other words, as of the time of the subsidy bestowal. The investigating authority performs this task during the original countervailing duty investigation, and it also allocates - or amortizes - the measured subsidy "benefit" over a period of years at this same time. In a subsequent administrative review, the investigating authority does not re-identify, or re-value, the "benefit," although it may modify the allocated "benefit" stream based on events occurring during the POR, as is explained more fully above in response to question 1 of the Panel's Questions to the Parties.

17. To our knowledge, this is the practice of every country that imposes CVD measures, including the EC. The EC has not argued that non-recurring subsidies *generally* may not be allocated over time, without re-valuing the benefit in each

year - only that privatization is a special case requiring an exception to the normal rule of non-re-valuation.

18. The United States also notes that in both the original countervailing duty investigation and in any administrative review, USDOC will examine whether any of the subsidies at issue could be considered to have been repaid, in whole or in part, subsequent to their bestowal. USDOC will recognize any monies returned to the government for the purpose of repaying a subsidy, and it does it essentially by subtracting the amount repaid from the allocated "benefit" stream calculated in the original investigation. Thus, there is no re-identifying, or re-valuing, of the subsidy "benefit" based on events occurring after the subsidy bestowal. USDOC continues to use the allocated "benefit" stream, as originally calculated based on events as of the time of the subsidy bestowal. USDOC considers post-subsidy bestowal events, in the case of repayment, only for the purpose of determining the appropriate allocation of the subsidy "benefit" over time. In other words, USDOC essentially allocates the subsidy "benefit" back to the government, without re-identifying, or re-valuing, the subsidy "benefit" based on events occurring after the subsidy bestowal.

Q.2. If this statement accurately portrays the methodology applied by the US, is the US of the view that under the SCM Agreement it is not required to take into consideration events that may offset a subsidy at the time of bestowal?

19. When identifying and measuring the subsidy "benefit," the investigating authority is only required to take into consideration events as of the time when the "financial contribution" was made or, in other words, as of the time of the subsidy bestowal. If there is an event occurring as of that time, such as the offset referenced in this question, the investigating authority would take it into account when identifying and measuring the subsidy "benefit."

20. The United States notes that the term "offset" is not defined in this question, and that term does not appear anywhere in the SCM Agreement in the context of the identification and measurement of the subsidy "benefit." It only appears in Article 10, footnote 36, and in Article 21.2, where the SCM Agreement talks about a countervailing duty being designed to offset the subsidization found to exist. In these contexts, the SCM Agreement used the term "offset" only to define the action that Members may take in imposing countervailing measures to counteract subsidies on imported merchandise. However, the only reference in the SCM Agreement to a post-bestowal modification in the subsidizing Member country is the concept of withdrawal in Article 19.1.

21. In its countervailing duty law, however, the United States does recognize and take into account certain "offsets" to the subsidy "benefit" that may exist as of the time of the subsidy bestowal. These "offsets" are set forth in Section 771(6) of the United States' countervailing duty statute, 19 U.S.C. § 1677(6), and they include:

(A) any application fee, deposit, or similar payment paid in order to qualify for, or to receive, the benefit of the countervailable subsidy,

(B) any loss in the value of the countervailable subsidy resulting from its deferred receipt, if the deferral is mandated by Government order, and

(C) export taxes, duties, or other charges levied on the export of merchandise to the United States specifically intended to offset the countervailable subsidy received.

As can be seen, the first two listed offsets simply recognize that the net benefit received may be different from the nominal benefit received. The third offset essentially permits the government of the exporting country to levy special duties, in place of countervailing duties imposed by the United States, for the express purpose of offsetting the subsidy. None of these offsets involves the revaluation of benefits from non-recurring subsidies after their original bestowal. Furthermore, these offsets described in US law should not be confused with the term "offset" as it appears in Article 10 and in Article 21.2.

Q.3. Is the US of the view that, when determining the existence of benefits under the SCM Agreement, it is not required to take into consideration events subsequent to the time of bestowal that may offset a subsidy?

22. No. The United States is of the view that, in determining the existence of benefits under the SCM Agreement, investigating authorities are not required to determine whether events subsequent to the time of bestowal of the subsidy may, if the subsidy is re-evaluated as of the time of such events, eliminate any continuing competitive advantage from the subsidy to the owner of the company on which the subsidy was bestowed. In its First Submission, the United States provided two examples of this point. One example was that

> if a government were to provide a specific producer with a smokestack scrubber in order to reduce air pollution, the Department would countervail the amount that the company would have had to pay for the scrubber on the market, notwithstanding that the scrubber may actually reduce the company's output or raise its cost of production.

General Issues Appendix, 58 Fed. Reg. at 37261. The other example was as follows:

> Similarly, the Department does not take account of subsequent developments that may reduce any initial cost savings or increase in output from a subsidy. For instance, if a government provides a piece of capital equipment to a company, the Department continues to countervail the value of that equipment as received, regardless of whether it subsequently becomes obsolete or is taken out of production.

Id. (citation omitted).

23. Indeed, as the United States explained at the first panel meeting, the USDOC similarly does not take into account subsequent developments that just as arguably may have increased the value of a subsidy. The example that the United States gave involved a subsidy for research and development that led to a

brilliant discovery and turned out to generate unexpectedly large profits for the subsidized company.

24. The United States notes, however, that the USDOC does take into account post-subsidy bestowal events in the separate context of allocating the subsidy "benefit," as explained more fully above in response to question 1 of the Panel's Questions to both Parties. The USDOC explicitly recognizes repayment of a subsidy to the government as a subsequent event that eliminates the subsidy repaid. Repayment is of the unamortized portion of the subsidy remaining. Recognizing repayment does not entail re-valuing the subsidy, an exercise which would involve redetermining the original benefit and calculating a new amortization table.

Q.4. The US has asserted that it would cease collecting countervailing duties in the event that a non-recurring subsidy is repaid at some time during the period over which that subsidy is allocated. Does the US consider that the SCM Agreement requires the cessation of collection of countervailing duties in such circumstances? If so, please indicate which provision(s) of the SCM Agreement contain(s) this obligation. If not, why would the US cease the collection of countervailing duties in such circumstances?

25. Where it is clear that a subsidy has been repaid in full or withdrawn, the United States believes that Article 19.1 requires the cessation of the collection of countervailing duties. The United States has recognized that repaying the unamortized portion of a non-recurring subsidy (which effectively includes interest on the principal amount) terminates the subsidy, so that the United States would be required to cease collecting countervailing duties in such cases.

Q.5. Can the methodology described in para. 50 of the US first submission be seen as a way to address the issue of possible offsets to subsidies?

26. The United States agrees that its repayment methodology is a way to determine that amount of the price paid for a subsidized company that may be treated as a payment for the prior subsidies. It would be fair to call this a "partial withdrawal," provided it were clear that the partial withdrawal was of the unamortized part of the subsidy originally received and allocated over time. The United States would not agree that whether the benefit originally received and allocated over time continued to constitute a competitive advantage to the new owners of the privatized company is a relevant consideration. The United States would not agree that the concept of "offset" is a relevant consideration in the context of a post-bestowal modification of subsidies, as explained above. The only relevant post-bestowal concept under the SCM Agreement in this context is withdrawal, as defined in Article 19.1. Therefore, we would not agree that the "offset" of a benefit (in the sense of the continuing advantage from the original subsidy) was a relevant consideration.

27. In other words, the United States does not consider the term "offset" to be equivalent to the withdrawal of a subsidy. Withdrawal of a subsidy must be of the unamortized portion of the benefit originally determined. The term "offset" should only be used in the context that it is used under Article 10 and Article

21.2 - i.e., the right of Members to counteract subsidies on imported merchandise.

Q.6. The methodology described in para. 50 of the US first submission allegedly indicates how much of the surviving benefits "pass through" to a privatized company, by allocating such benefits between sellers (the government) and buyers (private investors). How can this allocation be represented by the ratio of non-recurring assets to net worth, times the purchase price? What is the principle involved?

28. USDOC concluded that privatization could entail the repayment of prior subsidies to the privatized company to the government as part of the purchase price. To the extent this occurred, the prior subsidies would be extinguished. This raised the question - to what extent did the purchase price constitute the repayment of subsidies? USDOC answered that question by posing another - how much of what was being purchased consisted of subsidies? Put another way - to what extent was the price paid for the privatized company attributable to prior subsidies? In order to answer this final question, USDOC attempted to determine the proportion that subsidies historically comprised of the company's net worth.

29. From USDOC's point of view, this approach addressed the privatization issue without doing violence to a basic premise of the SCM Agreement and its law - that benefits received by foreign producers from their government on terms inconsistent with commercial considerations constituted countervailable subsidies. On the other hand, the solution did not require USDOC to ignore the fact that the price paid for a subsidized company may have been higher than it would have been absent any subsidies, so that at least some of that price should be treated as a repayment of those subsidies.

30. The United States also notes that, in this dispute, the EC has only claimed that any privatization methodology that does not treat an arm's length, fair market value transaction as cutting off previously bestowed subsidies violates Articles 1.1, 10, 14 and 19.4. The EC has not claimed that even if USDOC's privatization methodology does not violate Articles 1.1, 10, 14 and 19.4 by failing to treat an arm's length, fair market value transaction as cutting off the prior subsidies, it nevertheless violates Articles 1.1, 10, 14 and 19.4 on the ground that the calculation, or the principle underlying it, used by USDOC actually to allocate the prior subsidies between the government and the successor, privatized company is somehow unreasonable.

31. The United States also notes that the SCM Agreement, in any event, does not get down to the level of detail of prescribing the specific calculations that an investigating authority must use when allocating subsidies. As the United States explains in its Rebuttal Submission, while the SCM Agreement recognizes the concept of allocating subsidies over time, it is silent on the mechanics of allocation.

Q.7. According to the method described in para. 50 of the US first submission, the lower the proportion of non-recurring assets to a company's net

worth, the larger the share of benefits that is passed on to the privatized firm. Why is this so?

32. The United States first notes one point of clarification. The United States assumes that the reference to "the ratio of non-recurring assets to net worth" means "the ratio of non-recurring *subsidies* to net worth."

33. It is generally true, as this question suggests, that the *smaller* the ratio of non-recurring subsidies received by the government-owned company to the government-owned company's net worth, the *larger* the share of benefits that is passed on to *the privatized company*. This result obtains because USDOC's calculation multiplies the ratio of non-recurring subsidies to net worth times the purchase price, and it is the resulting product - an amount equal to a portion of the purchase price - that is first allocated to the seller and deemed the repayment of subsidies; the remaining portion of the prior subsidies - not the remaining portion of the purchase price - is then allocated, or passes through, to the privatized company. When the ratio of non-recurring subsidies to net worth is relatively small, correspondingly less of the purchase price will be deemed the repayment of subsidies to the government and, therefore, correspondingly more of the prior subsidies will be passed through to the privatized company. The converse, of course, is also true. When the ratio of non-recurring subsidies to net worth is relatively large, correspondingly more of the purchase price will be deemed the repayment of subsidies to the government and, therefore, correspondingly less of the prior subsidies will be passed through to the privatized company.

34. The result that the share of prior subsidies allocated to the privatized firm decreases with the proportion of non-recurring subsidies to net worth over time is the result of increasing the proportion of the purchase price as dedicated to the retirement of subsidies, to the extent that non-recurring subsidies have constituted a high proportion of net worth over time. This may seem counter-intuitive at first, because it seems to make relatively small subsidies harder to repay than big ones. However, we believe that it makes perfect sense to allocate only a small portion of the price paid for a company that has received relatively small subsidies as repayment for those subsidies. Of course, because such subsidies are small, they actually are more easily repaid than large ones. The small proportion is taken from a relatively larger price, so that the total amount (if not proportion) dedicated to repayment of the prior subsidies may be very large.

Q.8. At para. 181 of its first written submission, the US argues that there is no need to determine whether the private firm under investigation benefited from any financial contribution if that firm purchased assets from a government-owned company that received non-recurring subsidies. Does the US consider that an arm's length privatization at fair market value has no impact on the presumption that subsidies conferred on the government-owned company will pass through to the new owners of the privatized company?

35. The United States considers that an arm's-length privatization at fair market value does not require investigating authorities to revalue the benefit conferred by the financial contribution that created the subsidy. However, the United States does consider that privatization effectively may entail the repayment of

some such subsidies and, to the extent that it determines repayment to have occurred, treats the subsidies as having been retired, so that liability for CVDs on those subsidies does not "pass through" to new owners of the privatized company.

36. USDOC takes into account the privatization transaction *not* by re-identifying, or re-valuing, the subsidy "benefit" as of the time when the privatization occurred. Rather, USDOC only identifies and measures the subsidy "benefit" once, based on events as of the time when the "financial contribution" was made, i.e., as of the time of the subsidy bestowal. As is explained above in response to questions 1 and 2 of the Panel's Questions to Both Parties, USDOC instead takes the privatization transaction into account through the way in which it allocates the subsidy "benefit." Essentially, it takes the "benefit" stream as originally allocated over a period of years under its normal allocation methodology and reapportions this "benefit" stream between seller and purchaser for the years following the privatization. The normal result under USDOC's approach is that a portion of the prior subsidies are allocated to and deemed repaid to the seller, which is the government, and a portion of the prior subsidies are allocated, or pass through, to the successor, privatized company.

Q.9. If this is so, the US appears to effectively argue that the benefit of the financial contribution is attached to the assets, and that the benefit of the financial contribution passes through to the new owner with those assets. If the benefit is attached to the assets, why is it that the full benefit of any prior financial contribution does not automatically pass through to the new owner when it acquires all of the assets of a government-owned company? If the benefit is attached to the assets, how will the benefit be neutralized on repayment of the subsidy?

37. The United States rejects the notion that subsidies "attach" to assets or to companies through the operation of any mechanism independent of the SCM Agreement. The SCM Agreement does not remotely address this question. The SCM Agreement requires simply that there be a financial contribution and that a benefit be thereby conferred. If this benefit is specific (and non-recurring), the Agreement permits the subsidy to be allocated over time, without regard to whether some subsequent event may have eliminated the competitive advantage to the owners of the subsidized company (be they the original owners or new ones) from having received the subsidy. The USDOC treats prior subsidies as having been withdrawn only to the extent that they have been repaid. The sale of a productive unit may be structured as either a sale of assets or a sale of shares, and it is reasonable to allocate some of the purchase price for either to the repayment of prior subsidies.

Q.10. Please explain how and why, in the case of the sale of the Richemont facility (see Exhibit USA-30), the USDOC found that all subsidies potentially allocable to Richemont were returned to the seller through the price paid by Usinor. Please comment on footnote 17 to the EC's first written submission in light of USDOC's findings regarding Richemont.

38. In the countervailing duty investigation of *Stainless Steel Sheet and Strip in Coils from France*, 64 Fed. Reg. 30774 (8 June 1999), USDOC applied its privatization methodology to the sale of Centrale Sidérurgique de Richemont ("Richemont"), which was a wholly owned subsidiary of Usinor, a company owned by the French government. The facts surrounding this transaction dictated that all of the previously bestowed subsidies be allocated back to Usinor, with no portion of these subsidies being allocated to the successor, privatized company. Specifically, when the simple average of the yearly ratios of non-recurring subsidies received by Richemont to Richemont's net worth was multiplied by the purchase price paid to Usinor, the resulting product was sufficiently high that *all* previously bestowed subsidies were allocated to Usinor. Consequently, *none* of the prior subsidies potentially allocable to Richemont passed through with it when it was privatized.

39. Because most of the data pertaining to this Richemont privatization transaction is of a business proprietary nature, it cannot be divulged in the context of this explanation. Nevertheless, a hypothetical scenario may help to clarify how the above result could occur. Assume that the government-owned company has a ratio of non-recurring subsidies to net worth equal to 1/4, or 25 per cent, and prior non-recurring subsidies of £250,000, and it is purchased at a price of £1,000,000. In this scenario, the portion of the purchase price allocable to the seller as representative of the prior subsidies would be .25 x £1,000,000, or £250,000. This amount, £250,000, is sufficient to cover all of the prior subsidies, which themselves totalled £250,000. As a result, none of the prior subsidies would be left to be allocated, or passed through, to the successor, privatized company. Instead, they would remain with the seller.

40. As the case of Richemont shows, the EC is wrong when it asserts in footnote 17 of its First Submission that "it is effectively impossible to avoid the pass-through of subsidies previously bestowed" under USDOC's privatization methodology. Rather, as the United States emphasized in its Oral Statement at the first panel meeting, one reason that USDOC's methodology is reasonable is that it pays particular attention to the facts of each case and does not predetermine one result or another. When the facts dictate that the product of the ratio of non-recurring subsidies to net worth and the purchase price is sufficiently high in relation to the prior subsidies, as in the case of Richemont, the result that obtains under USDOC's methodology is no pass-through of subsidies to the privatized company.

41. It is also apparent from footnote 17 of the EC's First Submission that the EC does not understand how USDOC's calculation works. The EC asserts "[a]verage prior subsidies would need to exceed the average net worth of the company" - or, in other words, the ratio of non-recurring subsidies to net worth would have to exceed one - for there to be no pass-through of subsidies to the privatized company.[438] As the above hypothetical scenario shows, the facts of a

[438] The United States explained at the first panel meeting that USDOC caps the ratio of non-recurring subsidies to net worth at one.

privatization transaction can lead to a determination that none of the prior subsidies pass through to the privatized company when the product of the ratio of non-recurring subsidies to net worth and the purchase price is sufficiently high in relation to the amount of the prior subsidies.

Q.11. At para. 181 of its first written submission, the United States submits that "there is no need … for a second benefit determination after the change in ownership." Is it the US position that USDOC did not, and was not required to, find "benefit" (within the meaning of Article 1.1(b) of the SCM Agreement) to UES and BSPLC in the relevant administrative reviews? If this is the US position, please explain why, in Section III ("Calculation of benefit") of the administrative review covering calendar year 1996, USDOC "first determined BS plc's benefits in 1996", and subsequently added "BS plc's and UES's benefits for each programme". Is it possible that such terms could imply that USDOC found benefit to UES and BSPLC?

42. The US position is that a "benefit" under Article 1 must be *identified and measured* only once, when the financial contribution is made. Once the benefit (from a non-recurring subsidy) has been identified and measured, it may then be allocated over time. After this allocation has been made, an investigating authority may find a benefit within a subsequent period of time by finding that the period over which the benefit from the original financial contribution is allocated includes that subsequent period, and determining the amount allocated to that period. The investigating authority need not re-value and re-allocate the original subsidy. In its administrative determinations, when the USDOC uses the term "benefit" it is referring to the process (or result) of determining the amount of the originally-determined benefit to be allocated to a particular period of investigation or review.

43. This question suggests that the two Article 1.1 "benefit" determinations advocated by the EC are (a) a "benefit" determination in the original countervailing duty investigation and (b) a "benefit" determination in a subsequent administrative review. To the contrary, the EC contends that Article 1.1 requires the investigating authority to establish, *first*, that a "benefit" was conferred by the "financial contribution" as of the time when the financial contribution was made, i.e., as of the time of the subsidy bestowal, and, *second*, that a "benefit" was conferred by the very same "financial contribution" as of the time when the ownership change took place. The EC contemplates that the investigating authority would make both of these determinations in the original countervailing duty investigation and would not re-visit these determinations in any subsequent review.

44. The United States is of the view that the investigating authority is only required to identify the Article 1.1 subsidy "benefit" once, based on events as of the time when the "financial contribution" was made, i.e., as of the time of the subsidy bestowal. Normally, this "benefit" determination is made in the original countervailing duty investigation, and the investigating authority does not re-visit the determination in any subsequent review.

Q.12. Does the USDOC change-in-ownership methodology only apply in the event that government-owned assets are sold to private companies, or can it also apply when privately-owned assets are sold to private companies? If such methodology does not apply in the context of privately-owned assets, why is this so?

45. The methodology also applies when privately-owned assets or shares are sold to other private companies. As in the case of privatization, a portion of the purchase price is allocated to payment of the unamortized subsidies of the company that is sold. Because the seller is not the government, however, these subsidies are not treated as having been repaid. Instead, the amount of subsidies that would have been retired in the case of a privatization simply remains with the seller. USDOC's methodology is explained in some detail in Exhibit USA-10, which sets out the Final Results of Redetermination Pursuant to Court Remand in *Delverde, SrL v. United States*, Consol. Court No. 96-08-01997 (CIT), dated 2 April 1998.

Q.13. In its concluding remarks at the first substantive meeting, the US referred to the market distortion caused by the transformation of a failed steel company into a new and improved steel company through subsidization. The US noted the EC argument that, when that steel company changes hands, the purchase price reflects the fact that it is now new and improved. The US asserted, however, that the new and improved company does not "shrivel up"; it is the new and improved steel company that is transferred. The US stated that therefore "the benefits [to the steel company] continue. The distortion that was introduced into the market-place by the original subsidy is still there. This is what we mean when we say that there is still a benefit, and still a subsidy."

Does the US suggest that a "benefit" (within the meaning of Article 1.1(b) of the SCM Agreement) will remain after an arm's length privatization so long as a market distortion caused by pre-privatization subsidization continues? If so, please explain the basis for this interpretation of the term "benefit" in Article 1.1(b), and please indicate whether the mere existence of the market distortion therefore justifies the imposition of countervailing duties on the privatized company.

At para. 188 of its first written submission, the US states that "the object and purpose of the SCM Agreement is, in fact, to deter and offset trade-distorting government subsidies benefiting merchandise and causing injury to an industry in the importing country." Does the US consider that it is also the purpose of countervailing duties to "offset trade-distorting government subsidies benefiting merchandise and causing injury to an industry in the importing country"? If so, please explain in detail if, and how, this approach is consistent with the definitions of "countervailing duty" contained in footnote 36 of the SCM Agreement and Article VI.3 of GATT 1994.

46. The United States does not suggest that the amount of market distortion actually caused by a subsidy can be measured and serve as the basis for assessing countervailing duties. The SCM Agreement permits countervailing duties to off-

set subsidies, not the amount of economic distortion caused by subsidies. This is true regardless of whether or not subsidized companies are privatized. The only basis for finding a benefit from a subsidy in the tenth year of the period over which that subsidy is allocated is the reasonable presumption that the benefit from that subsidy extends over time. This is the presumption that is embodied in the Agreement. The actual competitive advantage to a firm from receiving a subsidy may be more or less than the amount of the subsidy and may last for a longer or shorter period of time than the actual amortization period selected. If proof and measurement of the precise amount of economic distortion were conditions of imposing countervailing measures, the imposition of countervailing measures would become impossible. More to the point, the SCM Agreement requires no such demonstration.

47. To rebut the EC's argument that the arm's-length sale of a subsidized company necessarily eliminates such distortions, the United States emphasized the point that the arm's-length sale of a subsidized firm does not cause the company to "shrivel up," thus automatically eliminating whatever economic distortions remain from pre-privatization subsidies.

48. One weakness in the EC's argument is that Article 1.1 does not impose any requirement that the benefit inherent in the financial contribution be re-examined and demonstrated to confer a continuing advantage over time. If that were the case, investigating authorities would have to re-examine every non-recurring benefit every year, regardless of whether the ownership of the subsidy recipient had changed. In practice, investigating authorities determine the benefit as of the moment of the financial contribution and, if a specific subsidy is found to exist, allocate that subsidy over a reasonable period. Once an injury determination is made, the economic distortion is presumed to last over the amortization period and to end when the amortization period ends.

49. The United States does not rely on subsidies having any particular economic impact as a condition of countervailability. It relies on being able to countervail subsidies when the conditions for doing so in the SCM Agreement have been satisfied. These conditions are that there is a financial contribution which creates a benefit, specificity, and injury. The SCM Agreement embodies the presumption that subsidies continue to benefit production over time, and therefore does not require a demonstration or quantification of their continued effect. The essence of the EC's argument is to transform this presumption into a new condition that must be satisfied before countervailing duties may be imposed. To accept the EC's argument and impose this new condition would be tantamount to amending the SCM Agreement without the consent of the Members.

50. Finally, the United States would like to clarify that it was not attempting to argue, at the first panel meeting, that the existence of a "benefit" under Article 1.1 of the SCM Agreement following a privatization is in any way dependent on any inquiry into whether the market distortions caused by the pre-privatization subsidies are still there. The SCM Agreement - and, in particular, Article 1.1 - does not require the investigating authority to re-identify, or re-value, the "benefit" following a privatization. It is silent regarding what effect, if any, a privatization has on prior subsidies. Article 1.1 only requires the investigating authority to

identify and measure the "benefit" once, based on the events surrounding the original subsidy bestowal.

51. In referring to the market distortions caused by pre-privatization subsidies, the United States was only trying to address the likely reasoning behind the absence of any requirement in the SCM Agreement to treat an arm's length, fair market value privatization transaction as cutting off prior subsidies. The United States was also attempting to offer an alternative economic rationale to that proposed by the EC - a rationale which itself is not contained in the SCM Agreement. As the United States explained in its First Submission, the object and purpose of the SCM Agreement is to deter and offset trade-distorting government subsidies benefiting merchandise and causing injury to an industry in an importing country, and any focus on the purchaser in a privatization transaction - meaning the *new owner* of the privatized company - is therefore inadequate because it does not address the trade distortions which subsidies cause, particularly in the context of the market in a heavily subsidized industry like the steel industry.

52. Regardless of how the new owner may or may not be benefiting as a result of the privatization transaction, the subsidization continues to distort trade through artificially high output, through artificially low output prices resulting from the excess capacity which they created and through the reduced value of companies throughout the industry. Particularly when it reaches levels like £*7 billion* as in this dispute, the subsidization can also, for example, dramatically increase the competitiveness of a steel company by financing extensive modernization of facilities and the use of the most advanced production technologies, along with whatever training of workers is necessary, among other things. The sale of that company at a fair market price does not remove the subsidy-induced distortion caused by the company's strengthened steel production capabilities.

53. That being said, the United States is also of the view that the purpose of *countervailing duties* is to "offset trade-distorting government subsidies benefiting merchandise and causing injury to an industry in an importing country," provided that this formulation is not seen as suggesting that the existence of trade distortions is in any way relevant to whether a "benefit" exists within the meaning of Article 1.1 of the SCM Agreement. As the United States explained in its First Submission at paragraphs 189-206, the only inquiry into any type of trade distortion is found with regard to the determination of "injury" under Article 15 of the SCM Agreement. In contrast, the "benefit" determination under Article 1.1 is defined by Article 14, and it is simply based on a comparison of the terms of the "financial contribution" to the appropriate market benchmark as of the time when the "financial contribution" was made.

54. It is true that Article 10, footnote 36, of the SCM Agreement sets the countervailing duty that may be imposed by the investigating authority at an amount equal to the subsidy bestowed on the manufacture, production or export of the product, without referring to whether the subsidy is causing "injury" within the meaning of Article 15. However, to give any meaning at all to Article 15, it would seem necessary to interpret footnote 36 as contemplating that the imposition of the countervailing duty would only be imposed after a determination of "injury" under Article 15.

55. Article VI:3 of GATT 1994 reads essentially the same as footnote 36, and therefore it also does not expressly refer to any required "injury" determination. However, paragraph 6 of Article VI provides that "[no Member shall levy any ... countervailing duty on the importation of any product of the territory of another Member unless it determines that the effect of the ... subsidization ... is such as to cause or threaten material injury to an established domestic industry, or is such as to retard materially the establishment of a domestic industry."

Q.14. At paras. 102 - 104 of its first written submission, the United States argues that the Panel should apply the standard of review provided for in Article 17.6 of the AD Agreement. Please explain in detail whether and, if so, how the application of the Article 17.6 standard of review in the present case would be consistent with paras. 114 - 119, and especially para. 118, of the Appellate Body's findings in Hormones (WT/DS26/AB/R). In light of the Appellate Body's findings in Hormones, please explain in detail why the standard of review contained in Article 11 of the DSU should, or should not, apply in the present case.

56. The Appellate Body's decision in the *Hormones* case addresses whether the standard of review set forth in Article 17.6 of the Anti-Dumping Agreement should apply in disputes under the SPS Agreement, which is a WTO Agreement that does not have any standard of review expressed in it. The United States would agree that *Hormones* now means that the standard of review set forth in Article 17.6 of the Anti-Dumping Agreement does not apply in disputes under a WTO agreement, like the SPS Agreement, which does not have any standard of review expressed in it. Rather, the applicable standard of review is set forth in Articles 3.2 and 11 of the DSU.

57. However, it is the United States' position that the standard of review set forth in Article 17.6 of the Anti-Dumping Agreement is expressly made applicable to disputes under the SCM Agreement by virtue of the Ministerial Declaration on Dispute Settlement Pursuant to the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 or Part V of the Agreement on Subsidies and Countervailing Measures, which states "the need for consistent resolution of disputes arising from anti-dumping and countervailing duty measures." This Ministerial Declaration must have some meaning. In the United States' view, Members were aware of the many similarities between the anti-dumping proceedings and the countervailing duty proceedings that a panel would be reviewing, and they did not want inconsistent resolutions for disputes under the Anti-Dumping Agreement and the SCM Agreement simply because of the use of different standards of review. The import of the Ministerial Declaration is that a panel should use the Anti-Dumping Agreement's standard of review when reviewing a countervailing duty proceeding.

Q.15. In addition to the Ministerial Declaration cited at para. 103 of the US first written submission, on 15 December 1993 Ministers also adopted a Decision on Review of Article 17.6 of the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994. That Decision provides for a review of the standard of review set forth in Article 17.6 of

the AD Agreement, "with a view to considering the question of whether it is capable of general application." Could the fact that Members are to review whether the Article 17.6 standard of review is capable of "general application" suggest that the Article 17.6 standard of review is not at present of "general application"? What is the relevance, if any, of the abovementioned Decision in the present case?

58. The United States would agree that the standard of review set forth in Article 17.6 of the Anti-Dumping Agreement is not now generally applicable to WTO agreements. As explained above in response to question 14 of the Panel's Questions to the United States, the standard of review set forth in Article 17.6 of the Anti-Dumping Agreement does not apply in disputes under a WTO agreement, like the SPS Agreement, which does not have any standard of review expressed in it.

59. The Ministerial Decision on Review of Article 17.6 of the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 supports the view that the standard of review set forth in Article 17.6 of the Anti-Dumping Agreement is not now generally applicable to WTO agreements. However, this Ministerial Decision is not relevant in this dispute. The United States is not arguing that the standard of review set forth in Article 17.6 of the Anti-Dumping Agreement should be applied in this dispute because it is generally applicable. Rather, this dispute involves the SCM Agreement, and it is the United States' position that the Ministerial Declaration discussed in question 14 therefore makes the standard of review set forth in Article 17.6 of the Anti-Dumping Agreement expressly applicable to this dispute.

ATTACHMENT 2.4

RESPONSES OF THE UNITED STATES TO THE QUESTIONS FROM THE EUROPEAN COMMUNITIES AT THE FIRST MEETING OF THE PANEL

30 June 1999

QUESTIONS FOR THE UNITED STATES

Q.1. In the present case, the EC bases its interpretation of the Subsidies Agreement on "the ordinary meaning to be given to the terms of the treaty in their context", as Article 31:1 Vienna Convention requires. As this provision sets out, however, the object and purpose is of assistance in confirming this interpretation. Since the US has very different views regarding the object and purpose of the Subsidies Agreement and countervailing duties, the EC requests the US to clarify the following: the EC understands the object and purpose of Part V of the Subsidies Agreement to be intended to cover remedies applied by WTO Members to protect their domestic industries from the injurious effect of subsidized imports. Can the US explain where in Part V of the Subsidies Agreement it finds any basis for asserting that the object and purpose of countervailing duties is deterring and discouraging subsidization and preventing market distortions?

1. As a preliminary matter, the United States would reiterate that the panel in *Canada Civilian Aircraft* recently cautioned that

> the SCM Agreement does not contain any express statement of its object and purpose. We therefore consider it unwise to attach undue importance to arguments concerning the object and purpose of the SCM Agreement.

Canada - Measures Affecting the Export of Civilian Aircraft, WT/DS70/R, Report of the Panel, dated 14 April 1999, at para. 9.119, Notice of Appeal filed 3 May 1999.

2. The United States would also note that it formulated the object and purpose of the SCM Agreement differently from how the EC does in this question. In its First Submission at paragraph 188, the United States explained that the object and purpose of the SCM Agreement is "to deter and offset trade-distorting government subsidies benefiting merchandise and causing injury to an industry in the importing country." In addition, in its Oral Statement at paragraph 85 (emphasis in original), the United States stated that "a *detailed* statement of the object and purpose of the SCM Agreement might be difficult to agree on. But, certainly, at its most basic level the object and purpose of the SCM Agreement is to *discourage* subsidization ... ".

3. These formulations of the object and purpose of the SCM Agreement are not expressly found in Part V of the SCM Agreement. As discussed above, "the SCM Agreement does not contain any express statement of its object and purpose." *Canada Civilian Aircraft*, para. 9.119. Nevertheless, the fact that Part V of the SCM Agreement authorizes a Member's investigating authority to impose countervailing duties once it determines that a "subsidy" within the meaning of

Article 1 is causing "injury" within the meaning of Article 15 logically would seem to deter and discourage other Members from providing injurious subsidies.

4. The United States notes that the panel in *Canada Civilian Aircraft* basically agreed with the United States' formulations of the object and purpose of the SCM Agreement. It stated that "the object and purpose of the SCM Agreement could more appropriately be summarized as the establishment of multilateral disciplines 'on the premise that some forms of government intervention distort international trade, [or] have the potential to distort [international trade].'" *Id.* The panel in *Brazil - Export Financing Programme for Aircraft*, WT/DS46/R, Report of the Panel, dated 14 April 1999, at para.7.80, Notice of Appeal filed 3 May 1999, similarly stated that "the object and purpose of the SCM Agreement is to impose multilateral disciplines on trade-distorting subsidization".

Q.2. In paragraph 14 of its oral statement, the US states that what is at issue in this case is "a heavily subsidized company in a heavily subsidized industry". To which company is the US referring? Is it referring to British Steel Corporation or does it consider the privately-owned British Steel plc to be a "heavily subsidized" company? Please indicate where in the record of its published determinations that is before this Panel, the alleged subsidies provided to the private company British Steel plc (as opposed to the state-owned BS Corporation) are detailed and their benefits explained (including the US examination of the existence of any "benefit" conferred on British Steel plc).

5. The United States is referring to the government-owned company, British Steel, and the successor, privatized company, BS plc, in paragraph 14 of its Oral Statement at the first panel meeting.

6. The record citations requested by the EC are detailed in paragraphs 71 through 99 of the US First Submission.

Q.3. The US has also privatized companies that have received subsidies during their period of State ownership. Does the US consider for example the company USEC to still be a subsidized company? Does the US consider that USEC's subsidies still distort trade?

7. With regard to the EC's specific questions here, the EC has not provided any evidence concerning the alleged subsidies received by USEC or the details of its privatization. Therefore, the United States is not in a position to respond to these specific questions. However, as a general proposition, if a subsidized, US government-owned company were privatized on terms that properly resulted in the allocation of some portion of the prior subsidies to the successor, privatized company, the United States would have no basis for objecting to the imposition of countervailing duties if exports of products produced by the successor, privatized company caused injury to the domestic industry of another country.

Q.4. How could USDOC explain the apparent contradiction of accepting the market benchmark for the purposes of establishing a benefit to the state-owned company at the time of bestowal of the subsidy but rejecting it for the

purposes of establishing a benefit to the privatized company following privatization? Is this contradiction consistent with Article 14 ASCM?

8. There is no contradiction. This question wrongly assumes that the SCM Agreement requires the investigating authority to identify and measure a subsidy "benefit" within the meaning of Article 1.1 not only as of the time when the "financial contribution" was made or, in other words, as of the time of the subsidy bestowal, but also as of the time when the privatization took place. The SCM Agreement does not, however, require the investigating authority to identify and measure a subsidy "benefit" within the meaning of Article 1.1 as of the time when a privatization took place. Under USDOC's practice, once USDOC has identified and measured a subsidy "benefit" as of the time when the "financial contribution" was made, USDOC (like the EC) allocates it over time, without reassessing its value in each year of the amortization period. Neither the SCM Agreement nor USDOC ever addresses what an appropriate market benchmark might or might not be if an investigating authority were to attempt to follow an approach that did identify a subsidy "benefit" within the meaning of Article 1.1 as of the time when a privatization took place.

Q.5. If a subsidy is "repaid" to the government and is therefore extinguished under USDOC's practice, does this mean that the subsidy "benefit" is in fact re-valued in response to an event subsequent to the original determination? If so, is such re-valuation not in contradiction with the policy of not examining the use made of subsidies?

9. No. See the United States' responses to questions 1 and 2 of the Panel's Questions to Both Parties.

Q.6. The EC has made clear that its position is that the Subsidies Agreement requires the existence of a benefit and the corresponding existence of a subsidy before the goods of a company being investigated may be countervailed. Why has the US mischaracterized the EC approach as involving an inquiry into the 'use and effects' of the subsidy? How does the EC approach require an examination of the use and effects of the subsidy in the case of a state-owned enterprises which is privatized at fair market value?

10. As a preliminary matter, the United States notes that, in its view, an inquiry into the use and effects of a subsidy includes any inquiry into how a subsidy was used by the subsidized company after its bestowal, or what effect the subsidy had on the subsidized company after its bestowal, or how post-subsidy bestowal events in the marketplace may have affected the value of the subsidy.

11. Using the example of British Steel, the EC is looking at a "financial contribution," such as an equity infusion made in 1985, which, the EC admits, conferred a "benefit" when the "financial contribution" was made in 1985. The EC is calling for a second determination, which is whether that same 1985 "financial contribution" *continued to* confer a "benefit" when British Steel was privatized in 1988. This second "benefit" determination necessarily involves a re-examination of the "benefit" found to exist as of 1985 based on events subsequent to the 1985 "financial contribution." Specifically, as the EC has made plain in this dispute,

the EC contemplates that this second "benefit" determination would involve an examination of how the "benefit" found to exist as of 1985 was re-valued in the 1988 privatization transaction and whether, as a result of this re-valuation, it could be said that a "benefit" continues from the perspective of the new owner of the privatized company, BS plc, or perhaps from the perspective of BS plc itself.

12. In the United States' view, the EC's approach would overturn the presumption that the effect of a non-recurring subsidy is to provide a benefit over time - which is a presumption that underlies the allocation methodologies used by the United States, the EC and other Members and endorsed by the Informal Group of Experts - and replace it with a test of whether some post-subsidy bestowal event has eliminated this presumed effect of the subsidy. That is why the United States calls the EC's approach an "effects test".

Q.7. Under its methodology, USDOC attributes a portion of the purchase price to subsidies previously bestowed; considering that the factors taken into account in the gamma methodology involve events occurring after bestowal of the subsidy (e.g. the net worth of the company in the years before privatization but after bestowal of the subsidy) is this not an application in practice of an effects test?

13. No. See paragraphs 49-53 of the United States' Rebuttal Submission.

Q.8. On what basis does the US consider in paragraphs 182 and 187 of its First Written Submission that the Community argues that it is necessary to demonstrate that the firm under investigation is the actual recipient of the subsidy?

14. See paragraphs 101, 110, 111 and 112 of the EC's First Submission.

Q.9. If a company which received countervailable subsidies declares bankruptcy, is liquidated and its assets sold at auction for market value, would the US consider that each purchaser of assets or productive units received part of the subsidies and that the exports of each of those purchasers to the US could be appropriately countervailed under the Subsidies Agreement?

15. The SCM Agreement does not address what significance the sale of a subsidized company's assets or productive units in bankruptcy has with regard to previously bestowed subsidies. It is silent on this matter.

16. Consequently, at a minimum, if the investigating authority were to develop and apply a reasonable approach to this type of situation, it is the United States' view that the approach would not be inconsistent with the SCM Agreement.

17. As to how USDOC would handle this type of situation under its own practice, it is not clear. In all likelihood, it would depend, among other things, on the precise nature of the relevant bankruptcy laws and how they are enforced.

18. The United States notes that, well prior to the development of its current privatization methodology, the USDOC addressed the sale of assets in the context of a bankruptcy that took place in Canada, as the EC cites in footnote 4 of its

First Submission. That case was *Final Affirmative Countervailing Duty Determination; Oil Country Tubular Goods from Canada*, 51 Fed. Reg. 15037 (April 22, 1986) ("*OCTG from Canada*"). As USDOC explained when discussing the significance of this case in the General Issues Appendix,

> OCTG from Canada involved a situation where a company had become defunct and non-operational. Its assets were disposed of through a bankruptcy proceeding. This is a unique situation not involving the sale of an ongoing operating company exporting subsidized merchandise to the United States. That is not the case in any of the current steel investigations. Also, ... the issue of "privatization" [was not] specifically before the Department.

58 Fed. Reg. at 37263.

Q.10. Under Article 19.3 of the SCM Agreement :

> **"Any exporter whose exports are subject to a definitive countervailing duty but who was not actually investigated for reasons other than a refusal to cooperate, shall be entitled to an expedited review in order that the investigating authorities promptly establish an individual countervailing duty rate for that exporter."**

Supposing the US were to impose a countervailing duty on imports of a product from a state-owned company, and this company was subsequently privatized by means of an arm's-length sale to an unrelated purchaser for fair market value. Since the new exporter has never been investigated and has never refused to cooperate, it would presumably be entitled to an expedited review under this provision. Does the US agree with this conclusion?

On this basis, is it not clear that also at the time of the original investigation, it is the benefit to exporter (i.e. the exporting firm) during the investigation period which has to be established, rather than a benefit to the original recipient of the subsidy?

19. The United States does not agree with the EC's conclusion regarding a "new exporter" in this question. It appears that USDOC has not addressed the situation described in this question, and therefore the United States cannot say definitively how USDOC would handle it. The United States nevertheless expects that USDOC would not consider the successor, privatized company to be a new exporter.

Q.11. Article 21:1 Subsidies Agreement sets out that a CVD cannot remain if a subsidy is no longer "causing" injury (note that the drafters used the present/continuous tense here, indicating an ongoing injury). If a subsidy no longer exists because a benefit has been eliminated, how can the US claim that injury could be continuing?

Please confirm whether the US administrative reviews which are the subject of this case were conducted under Article 21:2 Subsidies Agreement.

20. Because the changes in ownership at issue in this case did not eliminate the previously bestowed subsidies, the situation assumed by the question - the absence of a subsidy - does not exist.

21. The United States confirms that USDOC conducted the administrative reviews at issue in this dispute pursuant to Section 751(a) of the US countervailing duty statute, 19 U.S.C. § 1675(a), which implements Article 21.2 of the SCM Agreement.

22. The United States notes that the EC has not raised any claims in this dispute under Article 21.2 of the SCM Agreement.

Q.12. Where in the text of Article 27.13 Subsidies Agreement is there an implied rule that subsidies provided before privatization at fair market value remain allocable to a private company after an arm's-length privatization?

23. The United States answers this question in detail in paragraphs 151-60 of its First Submission, paragraphs 32-35 of its Oral Statement at the first panel meeting, and paragraphs 56-66 of its Rebuttal Submission.

Q.13. In any event, what is the link between Article 27.13 Subsidies Agreement and countervailing duty investigations, and where does Article 27.13 Subsidies Agreement address the issue of privatization at fair market value in the context of such investigations?

24. See the United States' answer to question 12 above.

Q.14. In its First Written Submission to the Panel, the US asserted that US court decisions "represent an independent interpretation of a countervailing duty law that is indistinguishable from the SCM Agreement in the areas relevant to this matter" Although the EC does not accept that US court decisions are at all relevant in this case, it would nonetheless be interested to know where the US privatization language and treatment is set forth in the US Uruguay Round Agreements Act, the US interpretive Statement of Administrative Action and the US General Issues Appendix found in the text of the ASCM?

25. The United States is not certain that it understands this question. If the EC is asking for citations to where the privatization issue is addressed in the US countervailing duty statute, the accompanying Statement of Administrative Action and the General Issues Appendix, the citations are as follows.

26. In the US countervailing duty statute, it is Section 771(5)(F), which is quoted in its entirety in footnote 46 of the US First Submission. This section was added to the statute by the Uruguay Round Agreements Act ("URAA").

27. The Statement of Administrative Action (at page 258) addresses Section 771(5)(F). It explains:

> Section 771(5)(F) provides that a change in the ownership of "all or part of a foreign enterprise" (*i.e.*, a firm or a division of a firm) or the productive assets of a firm, even if accomplished

> through an arm's-length transaction, does not by itself require Commerce to find that past countervailable subsidies received by the firm no longer continue to be countervailable. For purposes of Section 771(5)(F), the term "arm's-length transaction" means a transaction negotiated between unrelated parties, each acting in its own interest, or between related parties such that the terms of the transaction are those that would exist if the transaction had been negotiated between unrelated parties.
>
> Section 771(5)(F) is being added to clarify that the sale of a firm at arm's-length does not automatically, and in all cases, extinguish any prior subsidies conferred. Absent this clarification, some might argue that all that would be required to eliminate any countervailing duty liability would be to sell subsidized productive assets to an unrelated party. Consequently, it is imperative that the implementing bill correct and prevent such an extreme interpretation.
>
> The issue of the privatization of a state-owned firm can be extremely complex and multifaceted. While it is the Administration's intent that Commerce retain the discretion to determine whether, and to what extent, the privatization of a government-owned firm eliminates any previously conferred countervailable subsidies, Commerce must exercise this discretion carefully through its consideration of the facts of each case and its determination of the appropriate methodology to be applied.

28. The relevant parts of the General Issues Appendix, which pre-dated the URAA, can be found in Exhibit USA-5.

Q.15. In considering its authority to review the USDOC's treatment of privatization in CVD cases, the US court held that:

> **Commerce's construction *must* be sustained if it falls within the range of permissible construction [of the Congressional statute]. ... The duty of the reviewing court is *not* to weigh the wisdom of, or to resolve any struggle between, competing views of the public interest, but rather to respect legitimate policy choices made by the agency in interpreting and applying the [Congressional] statute.**

In the US court appeal of the first post-ASCM challenge to the USDOC's privatization methodology, USDOC asserted to the reviewing US court that the court is to accord "*great deference* to the interpretation given the statute by the officers or agency charged with its administration" and that the court should "accord Commerce an even greater deference when reviewing, as here, Commerce's development and application of a complex methodology for use in a ... countervailing duty determination." How is the position that the USDOC has asserted to its own courts (that they are *required* to accord DOC "great deference") consistent with the position that

the US has advanced to this Panel that US courts render an "independent" interpretation of the ASCM?

29. In the cited court cases, the courts interpreted a countervailing duty law - the United States' countervailing duty law - which is not materially different from the SCM Agreement with regard to any of the provisions at issue in this dispute. The courts undertook their interpretation independent of USDOC, and they found the US statute to be silent with regard to the particular methodology that USDOC should apply to changes in ownership. In this regard, the courts agreed with USDOC. The courts then proceeded to determine whether USDOC's methodology represented a permissible construction of the statute, given its silence. In this part of the analysis, the courts gave deference to USDOC, as the expert agency charged with implementing the statute, with regard to how it filled in the statute's silence.

30. The review conducted by the US courts is very similar to what the Panel should do in this dispute. First, the Panel should determine for itself, using the customary rules of interpretation of public international law, whether Article 1.1 is silent with regard to how an investigating authority is to handle previously bestowed subsidies following a change in the ownership of the subsidized company. Assuming that the Panel finds Article 1.1 to be silent, it then should examine the methodology developed by USDOC and find that it represents a reasonable approach under the SCM Agreement.

Q.16. In Paragraph 145 of their first submission the US claim that the Informal Group of Experts report as well as EC's own countervailing duty laws "do not require a determination in each year of the allocation period that there is a continuing benefit from a subsidy". As regards the Informal Group of Experts report, is it not true that this report deliberately does not address the issue of benefit at all? Concerning the EC's countervailing methodology, please explain the basis for your conclusion with the appropriate documentary references.

31. The report of the Informal Group of Experts does not address the meaning of "benefit" in Article 1.1. It does, however, address whether the SCM Agreement requires a determination in each year of the allocation period that there is a continuing benefit from a subsidy. As is shown at pages 3-5, 5-6, 25-27 and 28-29 of that report, the Informal Group of Experts does not believe that the SCM Agreement requires a determination in each year of the allocation period that there is a continuing benefit from a subsidy.

32. The methodology used by the EC under its countervailing duty law is set forth in Guidelines for the Calculation of the Amount of Subsidy in Countervailing Duty Investigations, published in the Official Journal of the European Communities at OJ C 394, 17.12.98, p.12 (Exhibit USA-14). There, for example, in paragraph E(f)(vi), the EC makes clear that it only looks at events as of the time of the subsidy bestowal to identify the requisite "benefit." Addressing equity infusions, this paragraph states:

> The existence of a subsidy is determined by the information available to the parties at the time the equity infusion is made. Thus, if

> an investigation considers an equity injection that was made several years before, the fact that the company has performed less well than expected does not mean that a subsidy exists, provided that the expectation of a reasonable return was justified in the light of the facts know [sic] at the time of the provision of equity.
>
> On the other hand, a subsidy might exist even if a reasonable return has been achieved, if at the equity injection the prospect of such a return was so uncertain that no private party would have made the investment.

Later, in paragraph F(a)(ii), the EC specifically addresses how it relies on the original allocation of the subsidy "benefit," rather than any re-identification, or re-valuation, of that "benefit" during the period of investigation. It explains:

> For non-recurring subsidies, which can be linked to the acquisition of fixed assets, the total value of the subsidy has to be spread over the normal life of the assets (Article 7(3) of Regulation 2026/97). Therefore the amount of subsidy from, for example, a grant (for which it is assumed that it is used by the beneficiary to improve its competitiveness in the long term, and thus to purchase product assets of one kind or another), can be spread over the normal period used in the industry involved for the depreciation of assets. This will normally be done using the straight-line-method. For example, if the normal depreciation period was five years, 20 per cent of the value of the grant would be allocated to the investigation period (see example 6).
>
> The approach of allocating over time means that non-recurring subsidies granted several years before the investigation period can still be countervailed provided that they still have an effect during the investigation period.
>
> Conceptually, this kind of allocation is equivalent to a series of annual grants, each having an equal amount. In order to determine the benefit to the recipient, the appropriate annual commercial interest rate should be added to each grant, to reflect the benefit of not having to borrow the money on the open market. In addition, in order to reflect the full benefit to the recipient of having a lump sum of money at its disposal from the beginning of the allocation period, the amount of subsidy should be increased by the average amount of interest which the recipient would expect to earn on the non-depreciated amount of total grant over the whole period.

33. An example where the EC has applied this methodological approach in its practice is Council Regulation (EC) No. 2450/98 of 13 November 1998 imposing a definitive countervailing duty on imports of stainless steel bars originating in India and collecting definitively the provisional duty imposed, OJ L 304/1, 14.11.98, at p.5 (attached as Exhibit USA-34).

ATTACHMENT 2.5

SECOND SUBMISSION OF THE UNITED STATES
30 June 1999

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I. INTRODUCTION

1. At the first meeting of the Panel, the discussion focused principally on four issues, which included (a) the EC's evolving interpretation of the SCM Agreement provision at the core of this dispute, namely, Article 1.1, (b) the contextual significance of Article 27.13, (c) the relevance of repayment under Article 19.1 and (d) the standard of review. The United States addresses each of these issues in turn below.

II. ARGUMENT

A. The EC's Interpretation of Article 1.1 even as Modified at the First Meeting of the Panel, Finds no Support in the Ordinary Meaning of the Terms in Article 1.1 Given their Context and in Light of the Object and Purpose of the SCM Agreement

1. The Parties' Basic Disagreement

2. The EC's principal claim in this dispute - that USDOC did not "take all necessary steps" under Article 10 of the SCM Agreement to ensure that its imposition of countervailing duties conformed to the requirements of the SCM Agreement - hinges on the proper interpretation to be given to Article 1.1 of the SCM Agreement.

3. Article 1.1 is a provision that is quite brief and has virtually no relevant details. It simply provides that a subsidy exists if there is some type of "financial contribution" by the government and "a benefit is thereby conferred."

4. In its most basic form, the question which the Panel must resolve is, what is meant by the phrase "a benefit is thereby conferred"?

5. As the United States explained in its First Submission,[439] the ordinary meaning of the phrase "a benefit is thereby conferred," when read together with the context provided by Article 14, is clear. It means that the investigating authority must establish that a "benefit" was conferred by a "financial contribution" at the time when the "financial contribution" was made. To identify this "benefit," the investigating authority compares the terms of the "financial contribution" to the relevant market benchmark prevailing at the time when the "financial contribution" was made. For example, if the government made an infusion of equity into a company in 1985, and the period of investigation (or the period of review)[440] were 1990, the investigating authority would examine the prevailing market conditions in 1985 to determine whether the equity infusion conferred a "benefit".

6. The EC does *not* dispute this interpretation of Article 1.1. In fact, the EC acknowledged, in response to the United States' oral questions during the first meeting of the Panel, that it interprets Article 1.1 in precisely this way under its own countervailing duty law, just as does the United States under its countervailing duty law. Indeed, to the United States' knowledge, this interpretation of Article 1.1 is the only way in which any Member has *ever* interpreted Article 1.1 under its countervailing duty law.

7. The parties to this dispute disagree, however, when the EC contends that Article 1.1. *also* means something else. According to the EC, Article 1.1 *also* addresses specifically how to deal with the situation where the ownership of the

[439] US First Submission, paras. 112-36.

[440] The United States explains the difference between an investigation and an administrative review in its responses to questions 1 of the Panel's Questions to Both Parties and question 11 of the Panel's Questions to the United States.

subsidy recipient has changed hands several years after the "financial contribution" was made - in the above example, it might be 1988 - but prior to the period of investigation (or period of review).

2. The EC's Unsupported Interpretation of Article 1.1

8. The EC's interpretation of Article 1.1, as it stood at the end of the first panel meeting, had evolved considerably since the EC's First Submission. It now is as follows:

(a) According to the EC, Article 1.1 requires the investigating authority to determine whether a previously identified "benefit" from a financial contribution continued to exist after the time when the financial contribution was made and, specifically, as of the time when the ownership of the subsidized company changed hands.

(b) The EC finds this requirement in Article 1.1 by interpreting the term "benefit" in Article 1.1 as meaning a benefit to the "legal person" - meaning the company - who received the financial contribution. According to the EC, when a change in ownership of the subsidized company takes place through a sale of assets (but not a sale of shares), the successor company is a different company, and therefore a "benefit" cannot be said to exist with regard to this different company until the investigating authority actually examines whether this different company received any benefit as a result of the change-in-ownership transaction which created it.

(c) The EC asserts that an arm's length, fair market value change-in-ownership transaction involving a sale of assets cuts off all previously bestowed subsidies.

9. To understand the significance of the modifications that the EC has made to its interpretation of Article 1.1, and why they wholly undermine the EC's position in this dispute, it is first necessary to review specifically how the EC's interpretation of Article 1.1 has changed over time.

10. In its First Submission, the EC stated that Article 1.1 requires the investigating authority to establish not only that a "benefit" was conferred by the "financial contribution" as of the time when the financial contribution was made, but also that a "benefit" was conferred by the very same "financial contribution" as of the time when the ownership change took place. In addition, focusing expressly on the purchaser, meaning the *new owner* of the subsidized company,[441] the EC contended that, as an economic matter, a "benefit" within the meaning of Article 1.1 could not be considered to have continued following the change in ownership, assuming that it was accomplished through an arm's length, fair market value transaction. According to the EC, the new owner of the subsidized company would have paid exactly what the subsidized company and its subsidies

[441] EC First Submission, paras. 50-66, 103, 110, 127.

were worth, and therefore the new owner by definition did not receive any of the benefit from the subsidies.

11. The United States, in its First Submission, pointed out that the EC had failed to tie its interpretation of Article 1.1 to the text of Article 1.1 or even the context provided by Article 14. As a result, the EC erroneously read into Article 1.1 a requirement that does not exist, namely, the supposed requirement that the investigating authority determine whether a "benefit" already identified as of the time when the "financial contribution" was made, continued to exist years later and, specifically, as of the time when the ownership of the subsidized company changed hands.[442] The United States also pointed out that the EC had erroneously defined "benefit" in terms of a benefit to the *new owner* of the subsidized company, again without any textual support, and in contradiction of the SCM Agreement's focus on the benefit to the merchandise.[443]

12. In its Oral Statement at the first meeting of the Panel, the EC introduced for the first time the concept of a "legal person." Specifically, the EC argued that the only possible recipient of a financial contribution can be a "legal person."[444] The EC then extended this notion, i.e., the notion that a "legal person" is the entity that receives the financial contribution, in two ways. First, the EC stated that because a "legal person" is the entity that, as a practical matter, receives the subsidy funds, Article 1.1's bare reference to "benefit" really must mean benefit to the "legal person" who received the financial contribution.[445] Second, the EC then took benefit to the "legal person" who received the financial contribution and turned it into benefit to the *owner* of that "legal person."[446]

13. During the first panel meeting, the EC later conceded that the "benefit" contemplated by Article 1.1 is *not* a benefit to the *owner* of the "legal person." The EC stated that "benefit" refers to a benefit to the "legal person," meaning a benefit to the *company*. It was precisely the EC's focus on the new owner, however, which had enabled the EC to argue in the first place that an arm's length, fair market value transaction cuts off any continuing benefit from prior subsidies. The EC's entire discussion of the economics of privatization was based on the notion that an arm's length, fair market value transaction eliminates the benefit of prior subsidies when the existence of a benefit is considered from the perspective of the new owner.[447] The arm's length, fair market value nature of a transaction loses its significance when the existence of a benefit is instead considered from the perspective of the company or its production, as is discussed more fully below.

14. The EC further took the position for the first time that where a change in ownership is accomplished through a sale of *shares*, the subsidized company does not change. According to the EC, it is the same company, or "legal person,"

[442] US First Submission, paras. 182-84.
[443] Ibid., paras. 181.
[444] EC Oral Statement, paras. 41-49.
[445] Ibid., para. 49, EC Concluding Statement section.
[446] Ibid., paras. 7, 31 and 49.
[447] EC First Submission, paras. 50-66.

as before the change in ownership, and therefore any prior subsidies continue to benefit the subsidized company. The EC explained that only a sale structured as a sale of *assets* means - again, under Article 1.1 - that the subsidies are cut off. In the EC's view, in this situation, the subsidized company is a different company, and the investigating authority is therefore required to determine whether the prior subsidies continue to provide a benefit to this different company following the sale (and a sale of assets accomplished through an arm's length, fair market value transaction cuts off any continuing benefit).

3. Why the EC's Interpretation of Article 1.1 is Unsupportable

15. Given the way in which the EC's position has evolved, it is first necessary to resolve the meaning of the term "benefit" in Article 1.1, to the extent that it can be discerned. It is this term and the meaning that it is given, more than anything else, that shapes the analysis of the EC's two basic conclusions regarding the overall meaning of Article 1.1, i.e., the EC's conclusion, first, that Article 1.1 requires a second "benefit" determination, based on circumstances as they stand at the time of a change in the ownership of the subsidized company (where the change in ownership is accomplished through a sale of assets), and the EC's second conclusion that Article 1.1 treats an arm's length, fair market value change-in-ownership transaction (accomplished through a sale of assets) as cutting off the remaining "benefit" from previously bestowed subsidies.

16. In arguing that the term "benefit" in Article 1.1 means benefit to the "legal person" who received the financial contribution, the EC makes a series of assertions and assumptions which are unsupportable.

17. The EC's first assertion is that it is a "legal person" who receives the financial contribution. The United States notes that the SCM Agreement does not expressly address the matter of who or what receives the financial contribution. Certainly, neither Article 1.1 nor any other provision of the SCM Agreement uses the term "legal person." To the extent that "legal person" is a term used in the corporate law of some Member countries, moreover, there is no basis in the SCM Agreement for interpreting Article 1.1 as requiring an investigating authority to read that term into Article 1.1.

18. Nonetheless, as a practical matter, when a government provides a financial contribution, there must be an entity such as a company, or an individual, who receives, or takes possession of, the financial contribution.

19. But, even if it were assumed for the sake of argument that a "legal person" is the entity that receives the financial contribution, this circumstance has no relevance to what Article 1.1 means by the term "benefit". The EC treats it as relevant, without explaining why, and then turns "benefit" into "benefit to the 'legal person' who received the financial contribution." However, the nature of the entity or individual who receives, or takes possession of, the financial contribution has no bearing on what Article 1.1 means by the term "benefit."

20. Neither Article 1.1 nor the provision which provides the relevant context, Article 14, suggests that the "benefit" found to exist under Article 1.1 is intended as an indication of whether the financial contribution will benefit the "legal per-

son" who received the financial contribution, as the EC argues. In addition, as the United States has previously explained, the EC's focus on the "legal person" conflicts with the SCM Agreement's focus on the manufacture, production or export of the merchandise.

21. All that can be said is that the ordinary meaning of "benefit" is "advantage", as the *Canada Civilian Aircraft* panel has held.[448] Beyond that, Article 14 provides the relevant context. In fact, it is the only provision in the SCM Agreement that addresses the meaning of the term "benefit," and it simply states what the "benefit" is for four common types of financial contribution. The "benefit" is no more than, and no less than, the difference between the terms of the government financial contribution and the appropriate market benchmark prevailing at the time when the financial contribution was made.

22. Essentially, the SCM Agreement assumes that the subsidy "benefit", once identified and measured as of the time when the financial contribution was made, continues over time, and therefore may be amortized over time, without any further inquiries as to the continued existence of that "benefit".

23. At this point, it is now possible to consider the EC's first basic conclusion regarding the overall meaning of Article 1.1, which is that Article 1.1 requires the investigating authority to make the "benefit" determination not only once, as of the time when the "financial contribution" was made, but also a second time, based on the circumstances as they existed when the ownership of the subsidized company changed hands. Here, regardless of whether the Panel adopts the EC's or the United States' concept of "benefit", the analysis shows that Article 1.1 does not contain the requirement of a second "benefit" determination.

24. First, even assuming that the term "benefit" in Article 1.1 means benefit to the "legal person" who received the financial contribution, as the EC maintains, what is it about this definition that requires the investigating authority to determine whether the financial contribution continues to benefit the subsidized company after its ownership has changed hands? The EC views this definition as requiring the investigating authority to determine whether the subsidized company is the same or different following a change in its owners. In other words, the EC seems to say, if "benefit" really means benefit to the "legal person" who received the financial contribution, this definition is not satisfied if that "legal person" no longer exists and another "legal person" has taken its place.

25. But, even accepting this rationale, the further question that arises is, *how* is the investigating authority to determine whether a company is the same or different following a change in its owners? Here again, *nothing* in the text of Article 1.1 addresses this matter.

26. The EC takes the position that the subsidized company is the same company if the change in ownership is accomplished through a sale of *shares*, but it is a different company if the change in ownership is accomplished through a sale of *assets*. It is not clear on what the EC bases this position. It appears to be a gen-

[448] Panel Report *Canada - Aircraft, supra*, footnote 70, para. 9.119, Notice of Appeal filed 3 May 1999.

eral distinction drawn by the corporate law of some Member countries, but it is even further removed from the SCM Agreement than any of the other concepts that the EC has read into Article 1.1.

27. Indeed, any number of scenarios can be imagined where a change in ownership is not accomplished through a straight sale of shares or a straight sale of assets, and the corporate laws of various Member countries come up with different answers as to whether the company is the same or different. Is the EC arguing that Article 1.1 *requires* the investigating authority to make a general distinction between a sale of shares and a sale of assets, but leaves it to the discretion of the investigating authority to determine the significance of more complicated transactions? Or, is the EC arguing that Article 1.1 even explains how the investigating authority is to handle the more complicated transactions? And, whichever position the EC takes, where can any of it be found in the SCM Agreement? Plainly, the EC is going far beyond the terms of the SCM Agreement when it begins distinguishing between a sale of shares and a sale of assets.

28. The United States recognizes that nothing in Article 1.1 may *preclude* an investigating authority from taking the approach advocated by the EC. It may be reasonable for an investigating authority to fill in Article 1.1's silence with an approach based on the distinctions drawn by some version of corporate law, as the EC does when it advocates the use of a "legal person" concept and, further, differentiates between a sale of shares and a sale of assets. However, Article 1.1 does not *require* this approach. Rather, it would seem that a number of possible approaches could be used to fill in Article 1.1's silence, and the approach used by USDOC is one of them.

29. The United States views the term "benefit" in Article 1.1 as no more than, and no less than, the difference between the terms of the government financial contribution and the appropriate market benchmark prevailing at the time when the financial contribution was made. With this definition of "benefit," there is no basis for reading into Article 1.1 any of the additional requirements which the EC sees.

30. Consequently, regardless of which view of "benefit" is used, there is no basis for reading into Article 1.1 a requirement that the investigating authority make a second "benefit" determination, as of the time when the ownership of the subsidy recipient changed hands. Without this requirement, the EC's further conclusion that an arm's length, fair market value change-in-ownership transaction accomplished through a sale of assets cuts off previously bestowed subsidies becomes moot, given that it only becomes relevant if Article 1.1 is read as requiring a "benefit" determination as of the time when the ownership of the subsidy recipient changed hands.

31. Nevertheless, even if it were assumed that a second "benefit" determination were necessary, as of the time when the ownership of the subsidy recipient changed hands, there is no basis in the SCM Agreement for the notion that an arm's length, fair market value transaction cuts off previously bestowed subsidies. The original basis for that notion, offered by the EC in its First Submission, was that the term "benefit" in Article 1.1 meant "benefit to the new owner of the subsidized company." It was expressly from the perspective of the new owner, not

from the perspective of the company or its production, that the EC's economic analysis attempted to show the discontinuance of any benefit. In response to the United States' oral questions, however, the EC conceded that it is not proper to look at what benefit might be accruing to the new owner. The EC repeatedly stated that it only considered the perspective of the company to be correct. When an arm's length, fair market value transaction is viewed from the perspective of the company, the economic analysis changes. As the United States explained in its First Submission,[449] the company itself is not materially different following the change in ownership. The productive assets which benefited from the subsidies before the change in ownership are the same ones used by the new owner after the change in ownership.

32. Finally, even if all of the EC's extensions of Article 1.1 were accepted for the sake of argument, what would it mean for purposes of this dispute?

33. The first of the changes in ownership at issue - the creation of the UES joint venture in 1986 - was a complicated transaction in which the two companies forming the joint venture, British Steel and GKN, contributed assets in return for shares in UES. The EC has suggested that this transaction was essentially a sale of assets. Assuming that it was, that would mean that all of the subsidies previously bestowed on British Steel would have remained with British Steel after the creation of UES.[450]

34. When British Steel was subsequently privatized in 1988, this transaction was accomplished through a sale of shares. Under the EC's approach, this transaction would have no effect on the subsidies previously bestowed on British Steel. In other words, the previously bestowed subsidies would *not* be cut off. All of them would pass through (without any of the repayment allowed by USDOC's approach) to British Steel's successor, BS plc, because it was the same company.

35. The final change in ownership, in which BS plc acquired UES, was also accomplished through a sale of shares. It would have no effect on the subsidies previously bestowed on British Steel and passing through to BS plc, not because of the nature of the transaction, but rather because, under the EC's new approach, none of these subsidies would have been treated as passing through to UES in the first place when it was created in 1985.

36. At the end of the day, after all of the changes in ownership at issue have been accounted for, the result, under the EC's new approach, would be that *all* of the subsidies previously bestowed on British Steel would have passed through, and remained with, BS plc, the current producer of lead bar.

[449] US First Submission, para. 181.

[450] At the first panel meeting, the EC clarified its view that, in this situation, an arm's length, fair market value transaction would not extinguish prior subsidies, but rather would only cut them off, meaning that they would stay with British Steel and not pass through to UES.

B. The SCM Agreement Provides Little Guidance Regarding the Repayment of Subsidies

37. During the first panel meeting, the Panel inquired into how the SCM Agreement directs an investigating authority to handle the repayment of a subsidy and, further, whether it involved a re-examination of the subsidy "benefit" based on events taking place after the subsidy bestowal. The United States would like to clarify these matters here.

38. As a preliminary matter, the United States notes that the only provision in the SCM Agreement that addresses repayment is Article 19.1, and the EC has not made any claim in this dispute under that provision.

39. Turning to the actual text of Article 19.1, it can be seen that very little is actually said about repayment of a subsidy. In fact, the term "repayment" is not even used. Article 19.1 simply says that the investigating authority "may impose a countervailing duty in accordance with the provisions of this Article unless the subsidy or subsidies are withdrawn."

40. Assuming that the withdrawal of a subsidy is the same as, or at least includes, the concept of repayment of a subsidy, the text of Article 19.1 is silent on at least three relevant questions.

41. First, Article 19.1 does not address under what circumstances a subsidy can be considered repaid. In particular, for purposes of this dispute, Article 19.1 says nothing about whether a privatization - or any other event - is a circumstance where repayment of a subsidy takes place.

42. Second, Article 19.1 does not address how the investigating authority is to measure the amount of repayment. Thus, even it were assumed for the sake of argument that Article 19.1 somehow did identify a privatization as a circumstance where repayment of a subsidy takes place, Article 19.1 still says nothing about how the investigating authority must measure the amount of repayment. It certainly does not say that an arm's length, fair market value privatization transaction necessarily constitutes full, or even partial, repayment of a subsidy.

43. Third, Article 19.1 does not address whether it is necessary for the investigating authority to re-value the subsidy "benefit" when accounting for the repayment of a subsidy.

44. The United States can explain how USDOC answers these questions in its approach to the repayment of subsidies. Notably, at the first panel meeting, the EC endorsed USDOC's approach, at least in the non-privatization context.

45. In the repayment approach normally used by USDOC, i.e., outside the specific context of a privatization, there is no re-valuation of the subsidy "benefit," based on events taking place after the subsidy bestowal. The allocated "benefit" is instead reapportioned between the government and the subsidized company.

46. Under USDOC's approach, *before* USDOC even considers whether repayment has occurred, it would have already identified and measured the subsidy "benefit" and allocated it over time, all based on events as they stood at the time of the bestowal of the subsidy. More specifically, USDOC would have already allocated - or, essentially, amortized - the subsidy "benefit" over a period of years

(known as the allocation period) running from the bestowal of the subsidy pursuant to a standard declining balance formula that generates a net present value equal to the amount of the subsidy. As is explained in paragraph 44 of the United States' First Submission, this allocation assigns a portion of the subsidy "benefit" to each year of the allocation period. Using the example of a £100 million grant set out in paragraph 44, the benefit stream might look as follows:

Year	***Benefit***
1	15,555,600
2	15,000,000
3	14,444,500
4	13,888,900
5	13,333,300
6	12,777,800
7	12,222,200
8	11,666,700
9	11,111,100
10	10,555,600
11	10,000,000
12	9,444,500
13	8,888,900
14	8,333,300
15	7,777,800
16	7,222,200
17	6,666,700
18	6,111,100

47. It should be emphasized that Commerce's allocation methodology is no different from the allocation methodologies used by the EC and other Members and endorsed by the Informal Group of Experts. Like Commerce, all of these entities treat non-recurring subsidies as automatically benefiting the subsidized merchandise for a period of years.[451] Indeed, the EC's own countervailing duty regulations expressly state that the EC has "assumed" this automatic benefit.[452]

48. When USDOC proceeds to consider whether the subsidy has been repaid, it examines the allocated "benefit" stream. Here, USDOC normally considers the subsidy to have been repaid when the subsidy recipient pays the government the net present value of the remaining benefit stream. For example, in year 10, the subsidy recipient would have to return to the government the net present value of £75,000,100, which is the total of the amounts allocated to years 10 through 18.

49. As can be seen, this approach reflects USDOC's continued adherence to a fundamental interpretation of the SCM Agreement as not contemplating any re-identifying, or re-valuing, of the subsidy "benefit" based on events occurring af-

[451] *See* US First Submission, paras. 143-45; US Oral Statement, para. 98; Responses of the United States to the EC's Questions to the United States, response to question 16.
[452] *See* EC Countervailing Duty Regulations, OJ C 394, 17.12.98, p. 12 (Exhibit USA-14).

ter the subsidy bestowal. However, this does not mean that USDOC does not consider events after the subsidy bestowal in any part of its countervailing duty analysis. In fact, it does consider post-subsidy bestowal events, as in the case of repayment, when determining how to *allocate* the subsidy "benefit" over time.

50. Essentially, USDOC recognizes repayment by allocating the subsidy "benefit" back to the government.

51. USDOC recently addressed this point when issuing its countervailing duty regulations. There, it stated:

> When we say we do not consider "subsequent events" in the calculation of a subsidy, we generally are referring to events that arguably affect the subsequent performance (normally in terms of output or prices) of the subsidy recipient or its successor. We have never implied, however, that no subsequent event could ever affect the *allocation* of a subsidy. The Department may consider whether government or private actions occurring after the receipt of a subsidy should result in the reallocation of a subsidy as long as there is no tracing of the uses of the subsidy or the effect of the subsidy on the output or price of subject merchandise.[453]

52. In the particular context of a privatization, USDOC also recognizes the possibility of repayment of subsidies. Thus, in its recently issued countervailing duty regulations, after explaining that it was not adopting a regulation on privatization because various approaches were possible and the complicated and continually changing nature of privatization transactions warranted flexibility rather than rigidity, USDOC explained:

> Clearly, a post-subsidy change in ownership is an event that occurs subsequent to the receipt of the subsidy, and we have reallocated subsidies based on changes in ownership. It is entirely appropriate and consistent with the statute to consider whether a change in ownership is an appropriate occasion to reallocate countervailing duty liability for prior subsidies to the company that is sold.[454]

53. USDOC's practice in the privatization context is essentially the same as in the normal situation where the subsidy recipient simply returns money to the government. The amount of the required repayment is figured in exactly the same way. There is no re-identifying, or re-valuing, of the subsidy "benefit." The one difference is that, in the privatization context, it is a much more difficult task to determine the amount that has actually been paid back to the government. That is the task that USDOC set out to accomplish in developing a methodology involving the ratio of subsidies to net worth and the purchase price for the government-owned company.

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[453] Countervailing Duties; Final Rule, 63 Fed. Reg. 65348, 65354 (Nov. 25, 1998) (emphasis added) (attached as Exhibit USA-33).

[454] Countervailing Duties; Final Rule, 63 Fed. Reg. 65348, 65354 (Nov. 25, 1998) (emphasis added) (attached as Exhibit USA-33).

54. What all of this means for purposes of this dispute is, first, that there is no requirement in Article 19.1 that USDOC failed to follow when addressing the privatization of British Steel. In particular, the United States is of the view that Article 19.1 does not require it to treat an arm's length, fair market value privatization *per se* as constituting the withdrawal of a subsidy.

55. It also means that USDOC's approach to repayment, both generally and in the specific context of a privatization, is entirely consistent with the United States' interpretation of Article 1.1.

C. The EC's Attempts to Distinguish Article 27.13 are not Supported by the Ordinary Meaning of the Term in Article 27.13

56. In its First Submission, the United States explained that the EC's position regarding how Article 1.1 addresses changes in ownership is squarely contradicted by Article 27.13 and the context that it provides. In this regard, Article 27.13 creates an exception by establishing that certain types of subsidies provided by a developing country Member prior to privatization under certain circumstances will *not* be actionable under Part III of the SCM Agreement after privatization. Although 27.13 does not expressly state the general rule to which this exception applies, the only reasonable conclusion is that the general rule is that subsidies bestowed on a government-owned company's production prior to privatization normally *are* actionable after privatization.[455] In other words, they are not cut off by the privatization transaction, but rather pass through to the successor, privatized company. If this were not the case, Article 27.13 would serve no purpose.

57. The EC attempts to distinguish Article 27.13 in two ways. First, it insists that Article 27.13 only applies "with regard to new subsidies provided in the context of a privatization. Its [sic] says absolutely *nothing* about prior subsidies or their pass-through."[456] Second, the EC says that Article 27.13 is not applicable to the UK Government subsidies at issue in this dispute because Article 27.13 only applies in the context of Part III of the SCM Agreement and, further, it only applies to subsidies granted by developing country Members.[457]

58. It is not clear why the EC insists that Article 27.13 is confined to subsidies provided as part of the privatization transaction and does not apply to any subsidies bestowed prior to privatization. The EC simply makes this assertion without citing to any language in Article 27.13 that supports this interpretation.

59. A careful review of the language of Article 27.13 shows that it does apply to certain subsidies granted prior to privatization. The first sentence of Article 27.13 states that its exception from actionability applies to the enumerated types of subsidies when "granted within and directly linked to" a privatization pro-

[455] US First Submission, paras. 151-60.
[456] EC Oral Statement, para. 59 (emphasis in original).
[457] EC Oral Statement, para. 60.

gramme. The second sentence then makes clear that these subsidies need not be part of the privatization transaction itself, as the EC insists, but rather can be provided prior to privatization as a means of making the government-owned company a more attractive candidate for privatization. In this regard, the second sentence states two provisos, which are that the enumerated subsidies must be "granted for a limited period" and further that the privatization programme "result[ ] in eventual privatization of the enterprise concerned." Plainly, if the enumerated subsidies can be granted for any period of time, even a limited one, they can be provided prior to privatization rather than simply as part of the privatization transaction itself. Moreover, if the enumerated subsidies must only result in the "eventual" privatization of the government-owned company, they indisputably can be provided prior to privatization.

60. Notably, the third parties do not dispute that Article 27.13 is addressing pre-privatization subsidies. Rather, they accept this interpretation of Article 27.13, but attempt to distinguish it on other (inapposite) grounds.[458]

61. Thus, the Panel should conclude that Article 27.13 *does* refer to pre-privatization subsidies, and it *does* provide an exception for certain types of pre-privatization subsidies. The exception, again, is that they are *not* actionable under Part III, and the only reasonable conclusion is that the unstated but contemplated general rule is that all other types of subsidies pass through to the successor, privatized company and *are* actionable after privatization.

62. Meanwhile, the EC misses the point when it argues that Article 27.13 is simply not relevant to this dispute because it only applies in the context of a WTO proceeding under Part III of the SCM Agreement and, further, it only applies to subsidies granted by developing country Members. The United States is not arguing that Article 27.13 directs how an investigating authority must address subsidies in a Member's countervailing duty proceeding under Part V of the SCM Agreement, nor is it arguing that the United Kingdom is a developing country Member. Rather, the United States is making a contextual argument.

63. Certainly, Article 27.13 provides relevant context.

64. Article 27.13 is the only provision in the SCM Agreement that specifically addresses the issue of privatization, and the United States notes that it does so in a manner that is totally at odds with the EC's position in this dispute.

65. In addition, by contemplating that pre-privatization subsidies normally *are* actionable in a WTO proceeding under Part III after privatization, Article 27.13 necessarily assumes that the elements of a "subsidy" required by Article 1.1 - a "financial contribution" and a "benefit" - exist for these subsidies after privatiza-

[458] In its Third Party Submission, at para. 84, Brazil argues that the general rule implied by Article 27.13 is only that "Members may investigate *whether* pre-privatization subsidies are passed through to the post-privatization owners." It is unclear where Brazil finds this distinction in Article 27.13, as it does not cite to any of the text. In any event, given that Article 27.13 is directly applicable to WTO proceedings under Part III, the concept of an "investigation" by a Member is out of place. Members only conduct investigations under Part V. In its Third Party Submission, at para. 11 Mexico only seems to argue about whether Article 27.13 would be applicable to the case of a certain Mexican company.

tion. This means that, in Part III proceedings, any interpretation of Article 1.1 which treats the "benefit" of pre-privatization subsidies as being cut off by privatization conflicts with Article 27.13. Meanwhile, given that the very same Article 1.1 findings of a "financial contribution" and a "benefit" must also be made with regard to any pre-privatization subsidies addressed in a countervailing duty proceeding under Part V, the question that arises is whether, under the circumstances, there is any support for the notion that the SCM Agreement envisions a different, directly contradictory rule for identifying the Article 1.1 "benefit" - like the one advocated by the EC - for Part V proceedings. The United States sees no reason for any such distinction between Part III and Part V proceedings in this context, and the EC has offered none.

66. For all of these reasons, Article 27.13 should be viewed as providing relevant context for interpreting Article 1.1, and this context supports the United States' interpretation of Article 1.1.

D. In the Event that the Panel Finds the Standard of Review Set Forth in Article 17.6 of the Anti-Dumping Agreement Inapplicable to this Dispute, the Appellate Body's Decision in Hormones *States the Applicable Standard of Review, Except that the* Hormones *Decision does not Address what a Panel Should do in the Situation where the Agreement at Issue is Silent*

67. In the event that the Panel finds the standard of review set forth in Article 17.6 of the Anti-Dumping Agreement inapplicable to this dispute, the United States would agree that the Appellate Body's decision in *EC Measures Concerning Meat and Meat Products (Hormones)*, WT/DS26/AB/R, WT/DS48/AB/R, Report of the Appellate Body, adopted on 19 February 1998, at paragraphs 114-19, states the applicable standard of review.

68. The United States notes, however, that the *Hormones* decision does not represent a complete statement of the standard of review that must be applied by the Panel in this dispute. In particular, with regard to legal questions, the *Hormones* decision explains only that a panel must apply the customary rules of interpretation of public international law. It does not address what a panel should do in the situation where the agreement at issue is silent with regard to a particular matter even after applying the customary rules of interpretation of public international law. That is precisely what is at issue, here, however. The key provision in the SCM Agreement - Article 1.1 - is silent regarding how an investigating authority is to handle previously bestowed subsidies following a change in the ownership of the subsidized company.

69. This same type of situation would be presented if a dispute were to center on, for example, any number of other issues relating to the allocation or amortization of subsidies, such as when to expense or allocate subsidy benefits, the appropriate allocation period, the time value of money, adjustments for inflation and interest and the appropriate sales denominator in the *ad valorem* subsidy rate calculation. With regard to these issues, the SCM Agreement is silent, and indeed it is for this reason that the Committee on Subsidies and Countervailing Measures

commissioned the Informal Group of Experts to make recommendations on these issues, albeit for purposes of Annex IV and Part III of the SCM Agreement.

70. When the Tokyo Round Subsidies Code was in force, a similar study was commissioned specifically with regard to countervailing duty proceedings, again because of the silence of the Subsidies Code in this area. This study resulted in recommendations, to which the Contracting Parties later agreed, as set out in the Guidelines on Amortization and Depreciation.[459] There are no similar guidelines for a Member to follow under the SCM Agreement.

71. In any event, the United States submits that, when the agreement is silent, a panel addressing a dispute under Part V of the SCM Agreement should follow either *United States Salmon*, where the panel stopped its analysis and found the challenged approach to be not inconsistent with the agreement after determining that the agreement was silent,[460] or *New Zealand Electrical Transformers*, where the panel took a slightly different approach and found no violation of the agreement after concluding that the approach used by the investigating authority "appeared to be a reasonable one."[461]

72. In this dispute, moreover, the USDOC determinations at issue must be upheld, regardless of whether the Panel follows *United States Salmon* or *New Zealand Electrical Transformers*. Under *United States Salmon*, of course, the Panel would stop its analysis after finding Article 1.1 silent and find no violation of the SCM Agreement. Meanwhile, under *New Zealand Electrical Transformers*, which seems to require a reasonableness showing, the United States has explained in some detail why USDOC's change-in-ownership methodology is sound and well-reasoned. The EC, on the other hand, has not challenged this methodology on the ground that it is unreasonable. The EC has only argued that the SCM Agreement is not silent and, in fact, requires USDOC to use a different approach.

73. Finally, the United States notes that, at one point during the first meeting of the Panel, the EC took the position that if the Panel were to find the SCM Agreement to be silent with regard to how an investigating authority is to handle previously bestowed subsidies following a change in the ownership of the subsidized company, the Panel should find that USDOC's methodology is inconsistent with the SCM Agreement. This position finds no support in any WTO Appellate Body or panel report or any GATT panel report, and it is directly contradicted by reports such as *United States Salmon* and *New Zealand Electrical Transformers*.

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[459] BISD 32S/154.

[460] The relevant part of the *United States Salmon* panel report is found in *United States - Imposition of Countervailing Duties on Imports of Fresh and Chilled Atlantic Salmon from Norway*, SCM/153, Report of the Panel (unadopted), dated 4 December 1992, at paras. 243-46 and 247-49.

[461] The relevant part of the *New Zealand Electrical Transformers* panel report is found in *New Zealand - Imports of Electrical Transformers from Finland*, L/5814, Report of the Panel, adopted on 18 July 1985, 32/S55, 66-67, at paras. 4.2-4.3.

III. CONCLUSION

74. For the reasons discussed above, and for the reasons discussed in the United States' First Submission and the United States' Oral Statement at the first panel meeting, the United States respectfully requests the Panel to find that by imposing countervailing duties on leaded bar imports as a result of the 1994, 1995 and 1996 administrative reviews of the countervailing duty order on imports of lead bar products from the UK, the United States has not violated Article 1.1, 10, 14 or 19.4 of the SCM Agreement, nor has the United States nullified and impaired benefits accruing to the EC under the WTO Agreements.

ATTACHMENT 2.6

ORAL STATEMENT OF THE UNITED STATES SECOND MEETING WITH THE PANEL

14 July 1999

Introduction

1. Thank you, Mr. Chairman and members of the Panel. The United States appreciates this opportunity once again to present its views regarding the issues in this dispute.

2. As you know, the EC has filed a rather extensive Rebuttal Submission. In fact, it makes eleven different legal arguments.

3. But, with all of the arguments that the EC makes, one argument is tellingly missing. At no point in its submission does the EC address the ordinary meaning of the terms found in Article 1.1 and the context provided by Article 14. The EC continues to avoid addressing this crucial topic. Instead, the EC continues to press for an interpretation of these provisions which ignores their actual terms and instead promotes a reading of the SCM Agreement that incorporates and focuses narrowly on the concept of a "legal person," together with various misapplied corporate law principles which the EC apparently views as emanating from it.

4. Before we get to the EC's "legal person" theory and its ramifications, let me first attempt to crystallize the issues before the Panel.

The Issues Before the Panel

5. In this dispute, the Panel certainly is confronted with a multitude of complex concepts and considerations which the parties have raised. The change-in-ownership transactions at issue here are complicated enough, and the nature of change-in-ownership transactions generally continues to evolve and become more sophisticated every day. Questions have also been raised in this proceeding about whether the SCM Agreement's focus is on the company or its merchandise, or whether it is instead on the owner of the company. In addition, the parties differ regarding how economists view change-in-ownership transactions and even regarding whether economic theory is relevant in the first place. Then, switching from economic theory to corporate law, there have been assertions regarding the applicability of corporate law concepts such as "legal person" and how corporate law (in some countries) views change-in-ownership transactions accomplished variously through a full or partial sale of shares or sale of assets or any number of hybrid or mixed transactions.

6. Perhaps we should take a step back and simply ask, does Article 1.1 of the SCM Agreement really address these complicated matters? In the United States' view, it does not.

7. The EC tries to simplify this dispute by urging the Panel to look at one "fundamental" question.[462] It describes this question as whether the SCM Agreement requires that a "benefit" be found before a "subsidy" can exist and duties can be imposed. On this point, however, the EC and the United States are in complete agreement. There can be no question that a "benefit" must be found first. As explained in response to the Panel's written questions, the United States maintains that USDOC has determined that a "benefit" existed in each of the reviews at issue. The question before the Panel, therefore, is not whether an investigating authority must identify a "benefit" before a "subsidy" can be found to exist and duties can be imposed.

8. The United States submits that if the Panel is to understand what the real dispute is in what has become a rather complicated matter, it should focus on two basic questions.

9. The first question concerns who or what is the beneficiary of a subsidy. Basically, the EC says it is "who," and the United States says it is "what." As we will see, according to the EC, it is effectively the *owner* of the company that is the beneficiary. Although the EC several times states that the only proper focus is on the *company*, the rationale underlying its interpretation of Article 1.1 continues to be based on the new owner of the company following a change in ownership. The United States, on the other hand, views subsidies as benefiting the manufacture, production or export of merchandise.

10. This first question is especially important because it lays the foundation for the answer to the second basic question before the Panel, which is whether or not Article 1.1 requires a separate "benefit" determination when a change in ownership takes place.

11. Here, with its focus on the owner of the company, the EC takes the position that a separate "benefit" determination is required when the ownership of a company changes hands through a sale of assets (but not a sale of shares). If the new owner purchased the company through a sale of assets, the EC seems to be saying that the new owner would not be legally responsible for all of the liabilities of the company, and this fact somehow means that the company following the change in ownership is now different from the company before the change in ownership. It is a new, unrelated company, the EC says. In this situation, according to the EC, given that Article 1.1 requires that there be a "benefit" to the company under investigation during the period of investigation (or period of review), the investigating authority must determine whether the post-change in ownership company - the company under investigation - has received a "benefit".

12. The United States, meanwhile, arrives at the opposite conclusion. Because the United States focuses on the benefit to the manufacture, production or export of merchandise, and the productive assets are the same both before and after the ownership of the company changes hands, the United States does not make a separate "benefit" determination following the change in ownership.

[462] EC Rebuttal Submission, para. 26.

13. As we explain below, and indeed as the EC has already conceded, it is incorrect to interpret Article 1.1 as addressing a "benefit" to the owner of a company. Yet, that is what the EC does. However, when "benefit" is no longer viewed from the perspective of the owner, the EC's interpretation of Article 1.1 in the change-in-ownership context falls apart. At the very least, the EC can no longer argue that a separate "benefit" determination is *required* following a change in ownership. As a result, the EC has no basis for claiming that the actions of USDOC in the reviews at issue are inconsistent with any provisions of the SCM Agreement.

The Identification of a "Benefit" in the Original Countervailing Duty Investigation and in an Administrative Review

14. Before proceeding further, it is important to clarify one matter so that it does not confuse the Panel's resolution of the real dispute between the parties. I am referring to how Members apply Article 1.1 in the original countervailing duty investigation versus in administrative reviews like the ones at issue in this dispute.

15. This explanation is necessary because the EC, at times, has suggested that the investigating authority's analysis of the Article 1.1 "benefit" *differs* depending on whether it is undertaken in the original investigation or in an administrative review. The EC has implied that, in an administrative review, unlike in the original investigation, the investigating authority would have to look at current circumstances, i.e., circumstances as they existed in the period of review, to identify the requisite "benefit".

16. Let me begin by stating plainly that, for purposes of this dispute, there is *no difference* between what the investigating authority does in the original investigation and what it does in an administrative review.

17. Moreover, there is no real dispute between the parties - or, at least, there should not be any dispute between the parties - on this matter. What I am about to describe is exactly how the United States, the EC and, to the United States' knowledge, every other Member interprets the requirements of Article 1.1 in the original investigation and in an administrative review.

18. In both the original investigation and an administrative review, the investigating authority examines events as they existed as of the time when the financial contribution was made in order to *identify* and *measure* the "benefit." For example, if the government made an infusion of equity into a company in 1985, and the period of investigation were 1990, the investigating authority would examine the prevailing market conditions in 1985 to determine whether, and to what extent, the equity infusion conferred a "benefit." Similarly, if the period of review were 1992, the investigating authority would still examine the prevailing market conditions in 1985 to determine whether, and to what extent, the equity infusion conferred a "benefit". The investigating authority next *allocates* this "benefit" over a period of years using one method or another. Then, at this point, the investigating authority is in a position to determine whether the subsidy provides a "benefit" that is countervailable in the period of investigation or the pe-

riod of review, whichever is the case. It does this simply by examining the "benefit" stream that has already been calculated, as we explain more fully in our responses to the Panel's written questions from the first panel meeting.[463] Thus, in the original investigation, if the "benefit" stream allocated a portion of the "benefit" to the year that is the period of investigation (1990 in the above example), the investigating authority would find a countervailable "benefit" in that period. Similarly, in an administrative review, if the "benefit" stream allocated a portion of the "benefit" to the year that is the period of review (1992), the investigating authority would find a countervailable "benefit" in that period.

19. That being said, at least in the United States, the investigating authority will look at events that took place *after* the time when the financial contribution was made for purposes *other than* to identify a subsidy "benefit" under Article 1.1. For example, USDOC will look at whether the subsidized company may have repaid the subsidy in whole or in part to the government. As the United States explains fully in its Rebuttal Submission[464], this analysis does not involve the re-identification of, or the re-valuation of, the Article 1.1 "benefit". It involves only a re-allocation of this "benefit." Specifically, USDOC examines the original "benefit" stream, which was calculated based on events as they existed as of the time when the financial contribution was made, and it reapportions it between the government and the subsidized company in order to recognize the extent of any repayment.

20. I would note, moreover, that repayment is an issue that the investigating authority could face in either the original countervailing duty investigation or in an administrative review. This is because the act of repaying a subsidy could take place at any time after the financial contribution was made. It is not an act that could only take place during the period of review.

21. In any event, the fundamental point is that, in both the original investigation and an administrative review, the common practice among Members is, first, to identify, measure and allocate the Article 1.1 "benefit" based on events as they existed as of the time when the financial contribution was made. Then, the investigating authority determines whether a countervailable "benefit" exists during the period of investigation or the period of review by reference to the already allocated "benefit" stream.

22. Now, let's turn to what is really in dispute here.

The Real Dispute Between the Parties Regarding the Proper Interpretation of Article 1.1

23. Article 1.1 is a provision that is quite brief and has virtually no relevant details. It simply provides that a subsidy exists if there is some type of "financial contribution" by the government and "a benefit is thereby conferred."

[463] *See* US Responses to Panel's Questions, responses to questions 1 and 2 of questions to both parties.
[464] *See* US Rebuttal Submission, part II.B.

24. The ordinary meaning of the phrase "a benefit is thereby conferred," when read together with the context provided by Article 14, is as follows. It means that the investigating authority must establish that a "benefit," in the sense of an advantage, was conferred by a "financial contribution" at the time when the "financial contribution" was made. To identify this "benefit," the investigating authority compares the terms of the "financial contribution" to the relevant market benchmark prevailing at the time when the "financial contribution" was made.

25. The "benefit" is no more than, and no less than, the difference between the terms of the government financial contribution and the appropriate market benchmark prevailing at the time when the financial contribution was made.

26. The EC does *not* dispute this interpretation of Article 1.1.

27. In fact, not only does the EC interpret Article 1.1 in precisely this way under its own countervailing duty law, but also, to the United States' knowledge, it is the *only* way in which any Member has *ever* interpreted Article 1.1 in a countervailing duty proceeding.

28. The real dispute begins when the EC takes the position that Article 1.1 requires the investigating authority to establish not only that a "benefit" was conferred by the financial contribution as of the time when the financial contribution was made, but also that a separate "benefit" was conferred by the very same financial contribution as of the time when the ownership change took place. For the EC, this means that the investigating authority must look at the events surrounding the change in ownership, including the market conditions prevailing at that time, and on that basis identify whether the "benefit" of the earlier financial contribution continues to exist.

The Rationale Underlying the EC's Interpretation of Article 1.1 Erroneously Focuses on the Owner of the Company

29. Where does the EC's interpretation of Article 1.1 come from?

30. In its Rebuttal Submission, the EC makes several statements that cloud the position that it is taking. I will do my best to state, in plain and direct terms, what the EC's position is. As we will see, the EC's interpretation of Article 1.1 comes from its erroneous focus on whether the new owner of the company following a change in ownership can be said to be benefiting from a subsidy. The EC never explains why this is the focus required by Article 1.1. It just seems to assume it, without support from the SCM Agreement.

31. In coming up with its interpretation of Article 1.1, the EC argues first that only a "legal person" can be the entity that receives the Article 1.1 "financial contribution." The EC uses the term "legal person" in the technical sense that it is used in the corporate law of some Member countries. The United States does not agree that it is necessarily a "legal person" who receives the financial contribution, but the United States has acknowledged that as a practical matter there must be some entity or individual who receives the financial contribution.

32. The more crucial matter is what the EC *does* with its "legal person" theory.

33. First, the EC turns the term "benefit" in Article 1.1 into "benefit to the 'legal person' that received the financial contribution."

34. But, that is not what Article 1.1 says. It simply says "benefit." It does not say benefit to the entity or individual who physically receives the financial contribution, whether that person could be considered a "legal person" under corporate law or not.

35. As I explained earlier, all that can be said is that the ordinary meaning of "benefit" is "advantage." Beyond that, Article 14 provides the relevant context. In fact, it is the only provision in the SCM Agreement that addresses the meaning of the term "benefit," and it simply states what the "benefit" is for four common types of financial contribution. The "benefit" is no more than, and no less than, the difference between the terms of the government financial contribution and the appropriate market benchmark prevailing at the time when the financial contribution was made.

36. Of course, nothing in the SCM Agreement *precludes* an investigating authority from adding to the "benefit" requirement of Article 1.1. It may even be possible for an investigating authority, in its own practice, to add the requirement of a showing that a benefit was conferred on the "legal person," as the EC advocates. Such an approach perhaps cannot be said to be inconsistent with Article 1.1. However, again, it must be recognized that Article 1.1 does not go that far, and therefore it would not be proper for the Panel to impose that interpretation on Members.

37. But, let's set this matter aside. Let's assume for the sake of argument that, in addition to the meaning given the term "benefit" by Article 14, it also means "benefit to the 'legal person' that received the financial contribution," as the EC advocates. The more crucial error that the EC makes is when it explains what is meant by "benefit to the 'legal person' that received the financial contribution" in the context of a change in ownership.

38. Here, in this context, the EC further changes the meaning of "benefit" to "benefit to the *new owner* of the 'legal person' that received the financial contribution," and that is another fundamental misinterpretation of Article 1.1.

39. Now, the EC has previously conceded that it is *not* proper to interpret Article 1.1 as focusing on the benefit to the owner of the "legal person", or as the EC also says, the owner of the company. Indeed, at the first panel meeting and in its various submissions for this second panel meeting, the EC has repeatedly acknowledged that it is the company itself that must benefit, not the owner.[465] It has even acknowledged, in one instance, that a financial contribution benefits the act of production, manufacture or export[466], as is the United States' position.

40. But, the EC is only paying lip service to the notion that it is the company itself (or perhaps the act of production, manufacture or export) that must benefit, not the owner. Despite mouthing its acceptance of this principle, the EC contin-

[465] EC Rebuttal Submission, paras. 42, 43, 47 and 56; EC Responses to United States' Questions, responses to questions 3, 4.b., 7, 10, 11, 12, 13, 14 and 24.
[466] EC Rebuttal Submission, para. 47.

ues to base its interpretation of Article 1.1 in the change-in-ownership context on a personal benefit to the *new owner* of the company.[467]

41. For example, the EC states emphatically: "The European Communities have *not* suggested that 'the object and purpose of the ASCM focuses on what commercially meaningful advantage is accruing to the *owners* of the successor privatized company'. The EC's position is that under the ASCM it must be demonstrated that the current *producer* being investigated ... benefits ... from a financial contribution."[468]

42. But, the EC then turns around and treats Article 1.1 as really being about a "benefit" to the owner of the company. Thus, it says: "A change in ownership ... merit[s] a new examination of the existence of the 'benefit' requirement for the *new owner*".[469]

43. Then, assessing a change-in-ownership transaction from the perspective of the new owner, the EC adds: "The payment of a market price ... necessarily precludes the notion that any 'benefit' would have 'passed through' to this *new private owner* as a basic matter of economics."[470]

44. The EC also continues to criticize the United States because the United States "ignores whether any benefit was conferred on the buyer and *new owner* of the productive assets."[471]

The EC's Interpretation of Article 1.1 Falls Apart When "Benefit" is No Longer Viewed From the Perspective of the New Owner Following a Change in Ownership

45. Now, what does all of this mean?

46. As we will see, the EC's interpretation of Article 1.1 falls apart when "benefit" is no longer viewed from the perspective of the new owner following a change in ownership.

47. The EC's focus on the new owner is crucial to the EC's interpretation of Article 1.1. Once it is assumed (as we are doing for the sake of argument) that "benefit" means "benefit to the company that received the financial contribution," it becomes necessary (in the EC's view) to establish whether the company - the "legal person" - following a change in ownership is the same as, or different from, the company before the change in ownership, given that the company before the change in ownership is the company that actually received the financial contribution. According to the EC, if the company is the same, no separate "benefit" inquiry would have to be made. If the company is different, a separate "benefit" inquiry would have to be made.

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[467] EC Rebuttal Submission, paras. 42, 43, 47 and 56; EC Responses to United States' Questions, responses to questions 3, 4.b., 7, 10, 11, 12, 13, 14 and 24.
[468] EC Responses to United States' Questions, response to question 10 (emphasis added).
[469] EC Responses to United States' Questions, response to question 7 (emphasis added).
[470] EC Rebuttal Submission, para. 10.
[471] EC Rebuttal Submission, para. 18.

48. So, how does the investigating authority establish whether the company is the same or different? According to the EC, Article 1.1 *requires* that the investigating authority look at the new owner. It is not clear how the EC derives this requirement from Article 1.1. It may be that the EC is relying on the reading that it gave to Article VI:3 of GATT 1994 and Article 10 of the SCM Agreement in its First Submission[472], even though it has since expressly abandoned that position.[473] In any event, the EC has taken the position that if the new owner purchased the company through a sale of shares, the company is the same, apparently because the new owner would be legally responsible - under corporate law - for all of the liabilities of the company. But, according to the EC, if the new owner purchased the company instead through a sale of assets, the company is different, again apparently because, under corporate law, the new owner would not be legally responsible for all of the liabilities of the company.

49. Thus, it is only through its focus on the owner of the company that the EC is able to argue that a company (in some cases) is different after a change in ownership and therefore warrants a separate "benefit" inquiry.

50. Let's see what happens when the EC's focus on the owner of the company actually is abandoned, as the EC has conceded it should be.

51. Now, when the EC inquires into whether the company following a change in ownership is the same as, or different from, the company before the change in ownership, and it can no longer argue that Article 1.1 *requires* the outcome to be based on a distinction which equates the owner with the company, there are perhaps several possible approaches that could be used. But, nothing in Article 1.1 dictates one approach or another.

52. It may even be that an approach that focused on the new owner of the company, such as the EC's shares versus assets approach, would be possible, although, in the view of the United States, there are several considerations that strongly counsel against it.

53. The EC's approach is, of course, far removed from the SCM Agreement's focus on the manufacture, production or export of the merchandise.

54. In addition, it is not even clear what the basis is for the EC's distinction between a sale of shares and a sale of assets in the first place. The EC seems to be saying that the new owner is legally responsible for all of the liabilities of the company only when the change in ownership is accomplished through a sale of shares, and therefore that is the only scenario where the company remains the same following a change in ownership. But, that is *not* the law in the United States, and it also does not appear to be the law in the EC.

55. Under US corporate law, if the change in ownership is accomplished through a sale of shares, the new owner steps into the shoes of the prior owner and becomes legally responsible for all existing and potential liabilities of the company, absent contractual agreement to the contrary. In the case of a sale of

[472] *See* EC First Submission, paras. 50-66, 85-91, 103, 110, 116 and 127.

[473] *See* EC Rebuttal Submission, paras. 42, 43, 47 and 56; EC Responses to United States' Questions, responses to questions 3, 4.b., 7, 10, 11, 12, 13, 14 and 24.

assets, it is a factual question as to whether the new owner becomes legally responsible for all existing and potential liabilities of the company. Specifically, it is a question of whether the company carries on substantially the same business under the new owner. Here, the factors examined include whether there is a continuation of management, personnel, locality, assets and general business operations, whether the seller exits the business after the transaction, and whether the company under the new owner holds itself out to be the effective continuation of the original enterprise. If an examination of these factors shows that the company is carrying on substantially the same business under the new owner, the new owner is legally responsible for all existing and potential liabilities of the company.[474]

56. In the EC, it appears that similar factors govern the determination of whether the new owner is legally responsible for the liabilities of the company. The factors here include whether the company under the new owner "continued to manufacture the same product at the same place with the same staff." It is not enough that the company "merely changed its name".[475]

57. Moreover, as a practical matter, the EC's approach would seem to involve the investigating authority in a hopeless morass. For one thing, change-in-ownership transactions are often extremely complex transactions, particularly when they involve a privatization. They often do not involve a simple sale of shares or a simple sale of assets. It would seem to require an expert in corporate law even to begin to figure out how to analyze some of these transactions, and even then it is unclear which Member's version of corporate law is supposed to be used.

58. Finally, independent of these considerations, the fundamental point remains that nothing in the SCM Agreement requires an approach that distinguishes between a sale of shares and a sale of assets in order to figure out whether a new "benefit" inquiry is required following a change in ownership. Certainly, nothing in Article 1.1 - or anywhere else in the SCM Agreement - directs the investigating authority to fill in the SCM Agreement's silence on changes in ownership with corporate law principles.

59. Now, let's briefly look at the next step in the EC's interpretation of Article 1.1, where the EC actually inquires into whether a "benefit" can be identified following an arm's length, fair market value change-in-ownership transaction . Here, too, the EC's focus on the owner of the company is crucial to the EC's analysis. The entire thrust of the EC's First Submission was to view an arm's length privatization transaction from the perspective of the new owner, not from the perspective of the company. It was from the perspective of the new owner that the EC's economic analysis attempted to show the discontinuance of any Article 1.1 "benefit." The EC continues to press that perspective in its Rebuttal

[474] *See, e.g.*, Corporation Practice Guide, para. 2710 (Aspen Law & Business 1997) (attached as Exhibit USA-37).

[475] *SCA Holding Ltd. v. Commission of the European Communities*, Case T-327/94, 1998 ECJ CELEX LEXIS 1139 (Ct. First Instance 1998) (attached as Exhibit USA-38).

Submission[476], again despite its acknowledgement of the impropriety of using that perspective.[477]

60. If the EC's focus on the owner of the company is abandoned with regard to this part of the EC's interpretation of Article 1.1, what happens? Clearly, the economic analysis changes if this transaction is not viewed from the perspective of the new owner but instead from the perspective of the company. It is no longer meaningful to argue that the new owner paid what the company and all of its subsidies may have been worth. Rather, as the United States explained in its First Submission[478], what is now relevant is that the company itself is not materially different following the change in ownership. The productive assets used in the manufacture, production or export of merchandise before the change in ownership are the same ones used after the change in ownership.

61. Thus, the EC's challenge to the actions taken by USDOC in the reviews at issue loses all merit when the EC's focus on the owner of the company actually is abandoned, as the EC has conceded it should be.

The Context Provided by Article 27.13

62. Now, I would like to turn to Article 27.13, which is the only provision in the SCM Agreement that specifically addresses the issue of privatization.

63. The EC knows that Article 27.13 is the only provision in the SCM Agreement that specifically addresses the issue of privatization, and the EC also knows that it does so in a manner that is totally at odds with the EC's position in this dispute. As a result, the EC has sought to render Article 27.13 inapposite in several different ways. None of these attempts, however, withstands scrutiny.

64. Previously, the United States has explained that the EC's position regarding how Article 1.1 addresses changes in ownership is squarely contradicted by Article 27.13 and the context that it provides. In this regard, Article 27.13 creates an exception by establishing that certain types of subsidies provided by a developing country Member prior to privatization under certain circumstances will *not* be actionable under Part III of the SCM Agreement after privatization. Although Article 27.13 does not expressly state the general rule to which this exception applies, the only reasonable conclusion is that the general rule is that subsidies bestowed on a government-owned company's production prior to privatization normally *are* actionable after privatization.[479] In other words, they are not cut off by the privatization transaction, but rather pass through to the succes-

[476] *SCA Holding Ltd. v. Commission of the European Communities*, Case T-327/94, 1998 ECJ CELEX LEXIS 1139 (Ct. First Instance 1998) (attached as Exhibit USA-38), para. 10.

[477] *SCA Holding Ltd. v. Commission of the European Communities*, Case T-327/94, 1998 ECJ CELEX LEXIS 1139 (Ct. First Instance 1998) (attached as Exhibit USA-38), paras. 42, 43, 47 and 56; EC Responses to United States' Questions, responses to questions 3, 4.b., 7, 10, 11, 12, 13, 14 and 24.

[478] US First Submission, para. 181.

[479] Ibid., paras. 151-60.

sor, privatized company. If this were not the case, Article 27.13 would serve no purpose.

65. In its Oral Statement at the first panel meeting, the EC gave two reasons why Article 27.13 should not be considered relevant by the Panel in this dispute. The United States addressed and refuted these arguments in its Rebuttal Submission. Now, the EC presents two new reasons for the Panel to ignore Article 27.13. It is these arguments that I will now address.

66. First, the EC argues that Article 27.13 applies only to "subsidies granted 'in connection with privatization', not pre-privatization subsidies as such."[480] On that basis, the EC then contends that Article 27.13 shelters the successor, privatized company even when it receives a subsidy directly as part of the privatization transaction, not just when it inherits previously bestowed subsidies from the government-owned company. It is irrelevant, however, if Article 27.13 *also* shelters subsidies provided to the successor, privatized company directly as part of the privatization transaction. The fundamental point is that Article 27.13 *does* apply to, and provide shelter for, certain pre-privatization subsidies. Given that fact, which the EC (like third parties Brazil and Mexico) now seems to concede, the obvious reason that Article 27.13 needs to apply to any pre-privatization subsidies at all is that, otherwise, those subsidies would be *actionable* following a privatization. Again, if the SCM Agreement did not contemplate that pre-privatization subsidies would be actionable following a privatization, Article 27.13 would serve no purpose.

67. The EC's other new argument is that Article 27.13 sheds no light on the meaning of the terms in Article 1.1 because "Article 27.13 *presupposes* the existence of a subsidy before it becomes relevant."[481] According to the EC, Article 27.13 cannot become context for interpreting Article 1.1 "simply because it is built on a hypothesis that the conditions of Article 1.1 are satisfied."[482] But, that *is* the point. The EC has made precisely the point that establishes why Article 27.13 *does* provide context for interpreting Article 1.1.

68. By contemplating that pre-privatization subsidies normally *are* actionable in a WTO proceeding under Part III after privatization, Article 27.13 necessarily reflects an assumption that the elements of a "subsidy" required by Article 1.1 - a "financial contribution" and a "benefit" - exist for these subsidies after privatization. At the very least, this means that, in Part III proceedings, any interpretation of Article 1.1 which treats the "benefit" of pre-privatization subsidies as being cut off by privatization (as does the EC's interpretation of "benefit") necessarily conflicts with Article 27.13.

69. Is there any reason for confining the context provided by Article 27.13 solely to interpretations of Article 1.1 in Part III proceedings and not also to interpretations of Article 1.1 in countervailing duty proceedings under Part V? Article 1.1 is the SCM Agreement's basic definitional provision, and it applies

[480] EC Rebuttal Submission, para. 75.
[481] Ibid., para. 78 (emphasis in original).
[482] Ibid., para. 80.

equally in Part III proceedings and Part V proceedings. The United States sees no reason for interpreting it differently depending on whether it is being applied in a Part III proceeding or a Part V proceeding, nor has the EC has offered any reason for doing so.

70. Article 27.13 therefore should be considered to provide context for interpreting Article 1.1 when Article 1.1 is being applied in either a Part III proceeding or, as in this dispute, a Part V proceeding.

71. As the United States has explained previously, moreover, Article 27.13 implicitly rejects the EC's notion that a subsidy "benefit" under Article 1.1 must be re-identified as of the time of a change in ownership, given that it contemplates a general rule that previously bestowed subsidies remain actionable and are allocable to the production of the successor, privatized company.

Other Matters

72. Mr. Chairman, that concludes my basic presentation. Nevertheless, the United States is compelled to address several of the arguments made by the EC in its Rebuttal Submission, even though they do not relate to the core of this dispute. The United States feels this need because, in many instances, the EC attempts to refute an argument that the United States has not made, or it simply misstates the United States' position. In order to avoid any confusion that the EC's arguments might cause, I will now address the more significant of the EC's errors as briefly as I can.

Productive Assets as the Recipient of a Subsidy

73. For one thing, the EC mischaracterizes the United States' view of the subsidy recipient.

74. The EC states that the United States interprets Article VI:3 of GATT 1994 and Article 10 of the SCM Agreement as meaning that a subsidy "is given to a productive asset."[483] The EC even claims that this interpretation is "central to the US position in this dispute."[484] The EC emphatically counters, in an argument extending for more than three pages, that subsidies "are received by legal persons, not inanimate objects."[485]

75. As I have stated above, while the United States does not agree that it is necessarily a "legal person" who receives the financial contribution, the United States has previously stated that as a practical matter there must be some entity or individual who receives the financial contribution. The United States has never maintained that the actual physical recipient of a financial contribution is a productive asset.

[483] EC Rebuttal Submission, para. 46.
[484] Ibid., para. 4.
[485] Ibid., para. 47.

76. What the United States has said is that Article VI:3 of GATT 1994 and Article 10 of the SCM Agreement provide that the purpose of imposing countervailing duties is to offset subsidies bestowed on the manufacture, production or export of the merchandise. In other words, these provisions contemplate that a subsidy benefits the manufacture, production or export of merchandise. And, again, the EC itself has acknowledged this point in its Rebuttal Submission. It states that "financial contributions benefit the *act* of production, manufacture, or export" and "provide an advantage for economic activities carried on by business enterprises."[486]

77. That does not mean, however, that the actual physical recipient of the subsidy is the productive assets themselves or the merchandise.

78. Thus, when the United States previously argued that "the productive assets which benefited from the subsidy before the change in ownership are the same ones used by the new owners after the change in ownership," it was not somehow suggesting that the subsidy recipient was the productive assets. Rather, consistent with the focus of Article VI:3 of GATT 1994 and Article 10 of the SCM Agreement, the United States was simply stating that it was appropriate to countervail imports from the successor company because it was continuing to use the very same productive assets as the predecessor company, i.e., the company that originally received the subsidy.

Whether the SCM Agreement Seeks Not Only to Offset But Also to Deter Subsidization

79. The EC also spends considerable time arguing that the SCM Agreement only seeks to offset subsidization, not to deter it. At first, it is not clear why the EC is even making this point. Then, the EC actually suggests that the United States has attempted to support its change-in-ownership methodology as a legitimate effort to "deter" subsidization, *not* to "offset" subsidization.[487]

80. Let me clarify the United States' position. In the United States' view, USDOC imposes countervailing duties in a change-in-ownership situation in order to *offset* the subsidization found to exist, just as is contemplated by Article 19.4 of the SCM Agreement. The United States does not impose any additional duties in an effort to *deter* subsidization.

81. That being said, the United States remains of the view that the mere existence of the disciplines found in the SCM Agreement inherently deters governments from subsidizing, and deterrence is indeed one of the purposes of the SCM Agreement.

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[486] EC Rebuttal Submission, para. 47 (emphasis in original).
[487] *See id.*, paras 59-68.

The Richemont Change in Ownership

82. The EC next looks at how USDOC handled the Richemont change-in-ownership transaction in *Stainless Steel Sheet and Strip in Coils from France*, 64 Fed. Reg. 30774 (8 June 1999), which is an example of where USDOC's methodology can result in no pass-through of subsidies to the successor company. Here, the EC fundamentally misrepresents USDOC's analysis as actually turning on whether or not the change in ownership was accomplished in an arm's length, fair market value transaction.[488]

83. Briefly, in the *Stainless Steel Sheet and Strip* investigation, USDOC applied its change-in-ownership methodology just as it has been described in this dispute[489], and it was on the basis of that methodology that USDOC found that none of the prior subsidies passed through from Richemont to the purchaser, which was a government-owned company. USDOC did *not* base this determination on the fact that the change in ownership was accomplished in an arm's length, fair market value transaction, as the EC represents to the Panel.

84. USDOC did find the fair market price of this transaction to be relevant, but not with regard to any of the prior subsidies. USDOC looked at the nature of the transaction price solely in order to determine whether the government could be considered to have provided new subsidies directly to Usinor, the parent company that sold Richemont to the government-owned company, as part of the change-in-ownership transaction itself.

The State Aids Code

85. In its Rebuttal Submission, the EC continues to maintain that its State Aids Code has "no bearing" on this dispute[490], despite the fact that the EC uses the State Aids Code as a guide when applying its countervailing duty law and the State Aids Code treats changes in ownership exactly the opposite of the position taken by the EC in the countervailing duty law context of this dispute.

86. The EC insists that no comparison is appropriate between the EC's State Aids Code and countervailing duty law because the two sets of laws use different procedural rules and provide for different remedies when subsidization takes place. The EC also adds that "[t]he *substantive rules* applying to EC State aids are entirely different from those applying to countervailing duty proceedings".[491]

87. First of all, it is hardly clear why the procedures and remedies of the two sets of laws are relevant to the issue of whether subsidization exists in the first place. That is the issue here, namely, whether subsidization is cut off or whether it survives a change in ownership.

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[488] *See id.*, paras. 95-100.
[489] *See* US First Submission, paras. 36-62.
[490] EC Rebuttal Submission, para. 91.
[491] EC Rebuttal Submission, para. 87 (emphasis in original).

88. Second, it is also not apparent what the EC means when it says that the substantive rules of the two sets of laws are entirely different. Plainly, both discipline subsidization. Meanwhile, the only substantive difference that stands out is the very matter that is at issue here. That is, the State Aids Code treats pre-privatization subsidies as passing through, in full, to the successor, privatized company, while the EC maintains that under countervailing duty law those same subsidies are cut off by the change in ownership.

89. The United States submits that there is no sound basis for arguing that different change-in-ownership rules are appropriate under the State Aids Code and countervailing duty law. The two laws plainly are attempting to discipline the same problems of subsidization. The United States therefore agrees with the following statements recently made in a speech by an EC commentator, familiar with the two sets of laws, speaking in his personal capacity:

> Most regional and international trade groupings have developed rules to control the granting of subsidies to enterprises by Member governments, particularly in the area of trade in goods. For example, WTO Members have undertaken to discipline subsidies through the Agreement on Subsidies and Countervailing Measures, while EU Member States' ability to grant subsidies is limited by the State aid rules defined by the EC Treaty. This discipline exists because it is recognized that subsidies on the whole involve a misallocation of resources, which can potentially distort trade and cause adverse effects to competing non-subsidized enterprises.[492]

The Cooper Article

90. Throughout its Rebuttal Submission, the EC quotes from the Article written by Professor Cooper, which is Exhibit EC-13, to support its position that an arm's length, fair market value change-in-ownership transaction cuts off prior subsidies.

91. Briefly, the Cooper Article was prepared as part of a submission commenting on countervailing duty regulations being proposed by USDOC. The submission was made by a group advocating that USDOC adopt a methodology that called for the extinguishment of prior subsidies following an arm's length, fair market value privatization transaction.

92. For purposes of this dispute, there are two key aspects of this Article which render it inapposite. First, the Article itself admits that it is not looking at the privatization issue from a legal perspective. It does not reference or discuss any provisions of the SCM Agreement or any provisions of the US countervailing duty law. Rather, the Article expressly purports to provide only an analysis from

[492] "Subsidies: Environmental friends or foes?", presented at the Cameron May International Law Conferences' 4th Annual Conference on Dispute Resolution on the WTO (18 June 1999), at para. 3 (attached as Exhibit USA-39).

an *economic* perspective.[493] Second, when the Article provides its economic analysis, it *only* analyzes the privatization transaction from the perspective of the *new owner* of the successor, privatized company. Again, as I have discussed at some length above, the EC itself has acknowledged that it is not appropriate to "focus[ ] on what commercially meaningful advantage is accruing to the owners of the successor privatized company."[494]

93. The appropriate perspective can be found in an Article written by Gary Hufbauer, who served as the US Treasury Department's chief negotiator on subsidies during the Tokyo Round and is currently the Reginald Jones senior fellow at the Institute for International Economics. In his article, Mr. Hufbauer explains:

> The EU ... argues that the new shareholders who paid "fair market value" for a company are not subsidized and shouldn't be penalized. But whether British Steel's new owners benefitted from the prior subsidies has no bearing on the competitiveness of the steel mills - which the subsidies pumped up massively.
>
> Does a subsidized firm's advantage somehow vanish as the company's shares are bought and sold from one day to the next? Under that theory, subsidies will evaporate as the firm's shareholder roster changes. This theory might gladden the hearts of shareholders, but it would eliminate much of the WTO discipline on subsidies to capital equipment.
>
> The EU next claims that the US authorities must somehow prove that the subsidies survived privatization - by quantifying the current price and output effects of $13 billion granted over a period of years - before imposing countervailing duties.
>
> As a participant in crafting multilateral subsidy rules, I find this burden-shifting argument to be particularly dangerous. Longstanding General Agreement on Tariffs and Trade guidelines allow governments to assume - without proving empirically - that subsidies create lasting competitive benefits. WTO members have recognized that it would be impractical or even impossible to prove subsidy effects in later years. Too much else is happening in the dynamic world economy. Hence it is enough to show that a subsidy has been provided and has not yet been fully amortized.
>
> Then, assuming the injury test is also met, countervailing duties can be lawfully imposed. Requiring the importing country to demonstrate the effect of the subsidy years after it was granted - as the EU recklessly insists - would undermine the discipline the Subsidies Agreement seeks to impose.
>
> The hypocrisy of this effort to excuse $13 billion in subsidies is astounding. In 1996, British Steel complained bitterly about subsi-

[493] *See* Exhibit EC-13, p. 3.
[494] EC Responses to United States' Questions, response to question 10.

> dies being pumped into Irish Steel - even though Irish Steel was about to be privatized. Why worry if the competitive distortion was about to vanish? Indeed, the EU itself requires illegal subsidies to be repaid in full with interest to the offending government, even if the recipient company has changed owners in the interim.[495]

94. Mr. Chairman, at a minimum, Mr. Hufbauer's Article shows that economists differ on the significance of a privatization transaction, contrary to the impression that the EC tries to make in this dispute.

95. Mr. Hufbauer's Article is also noteworthy for its recognition that the SCM Agreement takes a practical approach to subsidies and allows governments to assume that subsidies have lasting benefits. As Mr. Hufbauer explains, any approach that were to treat pre-privatization subsidies as cut off by an arm's length transaction would undermine the discipline that the SCM Agreement seeks to impose on subsidies.

Summary

96. In summary, the United States believes that the issue before the Panel, when properly understood, is a relatively simple one. The SCM Agreement does not direct how an investigating authority is to handle pre-privatization subsidies. It is silent. Under these circumstances, USDOC developed a sound and well-reasoned approach, and there is no basis for the Panel to find that USDOC acted in any way that was inconsistent with the SCM Agreement.

Conclusion

97. Mr. Chairman, that concludes my presentation. The United States looks forward to answering any questions that the Panel may have.

[495] "Why is the EU defending subsidies?", by Gary Hufbauer, guest opinion appearing in the *Journal of Commerce* (June 28, 1999) (attached as Exhibit USA-40).

ATTACHMENT 2.7

CONCLUDING STATEMENT OF THE UNITED STATES SECOND MEETING WITH THE PANEL

15 July 1999

1. Mr. Chairman, I will attempt to be brief and to focus on what is the core matter in dispute.

2. In this dispute, the Panel must decide how an investigating authority is to handle a change in ownership under the SCM Agreement. Specifically, what does the SCM Agreement *require*? As we have explained, the SCM Agreement is silent on this matter. It does not direct an approach that must be taken by the investigating authority.

3. Given these circumstances, USDOC developed and applied its own approach. It is an approach that is sound and well-reasoned. It is not the only approach that an investigating authority could develop. There are other possible ones. But, USDOC's approach is a possible approach, and it is not inconsistent with the SCM Agreement.

4. The EC, on the other hand, seeks a *per se* rule. The EC wants the Panel to establish a rule that there is no pass-through of previously bestowed subsidies following an arm's length, fair market value change in ownership. That is *unacceptable*. It is simply *not* required by the SCM Agreement.

5. Mr. Chairman, at this stage of the proceedings, it has become clear that one question is at the core of this dispute. This question has been formulated in two similar ways. According to the United States, the question is whether the manufacture, production and export of merchandise prior to the change in ownership is essentially the same as the manufacture, production and export of merchandise after the change in ownership. The other way in which this question has been formulated is whether the company prior to the change in ownership is the same as or different from the company after the change in ownership.

6. For purposes of this dispute, there is not much of a practical distinction between these two formulations of the question.

7. The United States answers this question essentially by looking at whether the operations of the company are the same, or different, following the change in ownership. The United States uses this focus because the SCM Agreement itself expressly states a focus on a subsidy as benefiting the manufacture, production or export of merchandise.[496]

8. Now, are there other possible ways to answer this question? Yes, there are. One approach even might be to base the answer on how a Member's own corporate law would analyze the situation. And, there are probably several other possible ways to do it as well. But, there is no *required* way.

[496] *See* US First Submission, paras. 188-206.

9. It is important to note, moreover, that USDOC's approach complies with all of the relevant SCM Agreement requirements that *do* exist. In particular, USDOC does find a "benefit" to exist during the period of investigation and the period of review. As we have explained, USDOC does this through an examination of the allocated "benefit" stream, just as all other Members do.[497]

10. Now, let's look at how the EC answers this same question. How does it answer it? Well, it doesn't. The EC actually asks a different question. It asks whether the *owners* of the company are the same or different following the change in ownership.

11. As we have seen, in its Oral Statement at this second panel meeting, the EC first states that any distinction between a sale of shares and a sale of assets is a distinction based on form and therefore is meaningless. Then, it says that it is instead necessary to - it is *required* by the SCM Agreement to - look at the "economic reality" of the transaction to determine whether the company is the same or different following the change in ownership.[498] So, how does an investigating authority do this? Well, we are still waiting to hear. The EC *never* says. Instead, the next thing that the EC says is that an arm's length, fair market value transaction cuts off the previously bestowed subsidies.[499] But, what does that have to do with the "economic reality" of the transaction? Specifically, how is a company the same or different based solely on the *amount* of the purchase price? It is not clear. It appears that the EC is essentially saying that all changes in ownership result in a new company. On what basis does the EC take this position? What is it in the SCM Agreement that *requires* it? Again, the EC does not say. What is apparent, however, is that the EC is exclusively focusing on the *owner* of the company, even though that is something that the EC repeatedly has conceded is contrary to the SCM Agreement.[500]

12. Mr. Chairman, let me just conclude by saying that *$13 billion* in subsidies do not simply *vanish*.

13. Thank you, Mr. Chairman.

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[497] *See* US Oral Statement (2d), paras. 14-21.
[498] EC Oral Statement (2d), para. 23.
[499] *See id.*, para. 24.
[500] EC Rebuttal Submission, paras. 42, 43, 47 and 56; EC Responses to United States' Questions, responses to questions 3, 4.b., 7, 10, 11, 12, 13, 14 and 24.

ATTACHMENT 2.8

RESPONSES OF THE UNITED STATES TO QUESTIONS FROM THE PANEL AT THE SECOND MEETING OF THE PANEL

30 July 1999

QUESTIONS FOR THE UNITED STATES dated 14 July 1999

Q.1. What is your understanding of the requirement found in Article VI:3 of GATT 1994, whereby: "No countervailing duty shall be levied on *any product* of the territory of any contracting party … in excess of an amount equal to the estimated bounty or subsidy determined to have been granted, directly or indirectly, on the *manufacture, production,* or export of *such product* in the country of origin ...". (Emphasis added). Does this provision, in the opinion of the United States, require the investigating authorities of the parties to determine that a subsidy has been granted on the manufacture or production of the specific product on which a CV duty is imposed?

Would it be permissible, under this provision, to base the imposition of such a duty on a determination of subsidization that has been granted 7-10 years earlier and/or to a different company, and/or on a production of different products taking place under different circumstances? Should this provision be understood as to require the investigating authority to determine that such a past subsidy is at least benefitting present production?

1. The United States' answer to the first of the Panel's questions is, generally, yes, Article VI:3 of GATT 1994 requires the investigating authority to determine that a subsidy has been granted on the manufacture or production of the product under investigation or review. The United States notes that Article VI:3 refers only to the type of product being manufactured, produced or exported, which is what USDOC in its practice calls the "class or kind of merchandise"; it does not refer to each exported item of merchandise, as may be suggested by the use of the term "specific product."

2. The United States believes it would be "permissible" to base the imposition of a countervailing duty on a determination of subsidization that has been granted 7-10 years earlier. We assume that the subsidy at issue is a non-recurring subsidy and that the period over which the subsidy benefit is allocated extends for at least 7-10 years. In that event, regardless of whether the proceeding is an investigation or an administrative review, it would be permissible for the investigating authority to find a subsidy to exist 7-10 years after its bestowal on the basis that the allocated "benefit" stream assigns a part of the subsidy benefit to the period of investigation or period of review. While the SCM Agreement does not *require* this approach, the United States believes that this type of allocation is reasonable and not inconsistent with any provision of the SCM Agreement.

3. The Panel next asks whether it would be permissible to base the imposition of a countervailing duty on a determination of subsidization that has been granted to a different company. Using the plainest meaning of the term "different," the United States considers as a general matter that it is inappropriate to

impose countervailing duties on a company for which investigating authorities have not found a subsidy. That is to say, we would not impose duties on a totally unrelated, non-successor company for which we had not found a subsidy. However, a full answer to this question would depend on what is meant by a "different company." Under USDOC's practice, if there has been a change in the ownership of a company for which we had previously determined a subsidy to exist, USDOC normally will impose some amount of duties on the successor company where the operations of the subsidized company before the change in ownership are essentially the same as the operations of the successor company after the change in ownership. Even though the "new" company may be considered a "different company" in some corporate or legal sense, we would not consider the successor company in this instance (i.e., where the operations of the successor company are essentially the same as those of the prior company) to be a "different company" for purposes of imposing countervailing measures.

4. The next question asks whether it would be permissible to base the imposition of a countervailing duty on a determination of subsidization that has been granted on a production of different products taking place under different circumstances. The United States' answer depends on whether the subsidy at issue is "tied" or "untied." For example, if a subsidy is "tied" to a product other than the product under investigation, USDOC would not countervail it. Otherwise, if the subsidy is "tied" to the product under investigation or not "tied" to any particular product, USDOC would countervail it.

5. We believe that this is a reasonable interpretation not inconsistent with any provision of the SCM Agreement. It is also consistent with paragraph 3 of Annex IV, the only provision that mentions the concept of tying, albeit in the context of calculating an *ad valorem* subsidy rate under the cost-to-government measurement standard for purposes of Article 6.1(a).

6. The last question asks whether Article VI:3 of GATT 1994 should be understood so as to require the investigating authority to determine that such a past subsidy is at least benefiting present production. The United States' answer is yes, in the sense that the investigating authority must at least examine the allocated "benefit" stream and determine whether an amount has been allocated to the period of investigation or period of review, as the United States explained in its Oral Statement (at paragraphs 14-21) at the second panel meeting.

Q.2. Article 19.3 requires CVDs to be imposed on a non-discriminatory basis on imports of the relevant product coming "from all sources found to be subsidized …". Thereafter, Article 19.3 refers to "sources which have renounced any subsidies in question or from which undertakings under the terms of this Agreement have been accepted." Article 18.1 provides for undertakings to be granted by (1) "the government of the exporting Member" and (2) "the exporter".

Does Article 19.3 not suggest that CVDs may only be imposed on imported goods when the "source" of the imported goods is found to be subsidized? If not, why not? Irrespective of your response to the preceding question, are the "sources which have renounced any subsidies in question or from which undertakings under the terms of this Agreement have been ac-

cepted" the same "sources found to be subsidized"? If not, why not? If so, what are these "sources"? Please explain whether Article 18.1 is relevant for the purpose of identifying these "sources"?

7. The United States does not agree that the first sentence of Article 19.3 suggests that countervailing duties may only be imposed on imported goods when the "source" of the imported goods is found to be subsidized. It is not intended to address that issue.

8. Admittedly, the first sentence of Article 19.3, containing the phrase "from all sources found to be subsidized ...", is not written with clarity. Nevertheless, in the phrase "from all sources found to be subsidized ...", the term "sources" would seem to be referring to the *countries* from which the imports were sourced. In other words, "found to be subsidized" modifies not "sources," even though that word appears immediately after it, but rather an earlier phrase found in the first sentence of Article 19.3, i.e., "imports of such product".

9. Three points support this interpretation. First, the sentence at issue is concerned expressly with non-discrimination, which relates to the GATT 1994 Article 1 principle of MFN, *i.e.*, basically a prohibition against treating one Member differently from another. This is confirmed by examining the *Second Report of the Working Party on Trade and Customs Regulations, Antidumping and Countervailing Duties*, BISD 9th Suppl., p. 198 at paragraph 26 (May 27, 1960). Where MFN is the topic, it only makes sense to talk about countries, not individual firms or exporters. Second, it is instructive to look at the corresponding provision in the Antidumping Agreement. There, Article 9.2 (like its predecessor in the Tokyo Round Antidumping Code) uses the phrase "from all sources found to be dumped ..." in a similar, non-discrimination context. There, "sources" could not possibly refer to the producer/exporter, as a producer/exporter cannot be found to be dumped. Third, Article 20.6 and Annex IV, note 65, similarly refer to "products" benefiting from subsidies.

10. Given this interpretation of the term "sources" where it first appears in Article 19.3, *i.e.*, in the phrase "from all sources found to be subsidized ..." found in the first sentence, it would seem that the same meaning would have to be accorded to it when it later appears in the same sentence in the phrase "sources which have renounced any subsidies in question or from which undertakings under the terms of the Agreement have been accepted". Nothing in Article 19.3 suggests that "sources" has two different, alternating meanings in this sentence.

11. Even if it is accepted for the sake of argument that it is the "sources" that must be "found to be subsidized," and that "sources" means producers/exporters, the United States has previously explained that when USDOC finds a firm to be subsidized following a change in its ownership, it does so in a manner that is not inconsistent with the SCM Agreement.

12. Finally, the term "undertakings" later in the first sentence of Article 19.3 would seem to be a reference to Article 18.1(a) undertakings, *i.e.*, undertakings by the government of the exporting Member. Although Article 18.1 itself lists two types of undertakings - undertakings by the government of the exporting Member and undertakings by an exporter - it would seem that the Article 19.3 reference is to undertakings by the government of the exporting Member, given

that it specifically refers to "sources" from which undertakings have been accepted.

Q.3. At paragraph 22 of its second written submission, the US argues that the SCM Agreement assumes that the "benefit" from non-recurring, untied subsidies continue in time, "without any further inquiries as to the continued existence of that `benefit'." Is this approach consistent with Article 21.3 of the SCM Agreement, whereby an authority must terminate CVDs unless it finds that the expiry of CVDs would be likely to lead to "continuation" or recurrence of subsidization? Doesn't a finding of likely "continuation" of "subsidization" require a finding of likely "continuation" of "financial contribution" and likely "continuation" of "benefit"? Wouldn't the US approach lead to the automatic extension of CVDs through the useful life of assets (beyond the initial five-year period of validity), without any determination that expiry would be likely to lead to "continuation" of "subsidization" (i.e., "continuation" of "financial contribution" and "continuation" of "benefit")? What provision[s] of the SCM Agreement form[s] the basis for the assumption that the "benefit" of non-recurring, untied subsidies continues over time?

13. As a preliminary matter, the EC has not made any claim under Article 21.3, which deals with five-year sunset reviews. Indeed, the reviews at issue were not sunset reviews under Article 21.3, but rather annual reviews under Article 21.2.

14. USDOC has just begun to conduct sunset reviews under Article 21.3, and has not yet encountered a case where it has had to determine the likelihood of continuation or recurrence of a non-recurring subsidy for which the benefit stream has not expired. However, USDOC has issued some relevant guidelines. With respect to long-term, non-recurring subsidies, USDOC has stated that it generally would consider there to be a likelihood of continuation of a subsidy if the benefit stream was not yet fully allocated. With respect to short-term, recurring subsidies, USDOC has stated that it would look to see whether the subsidy programme still existed, whether the company in question had a history of using the programme, and other relevant factors. *See, Policies Regarding the Conduct of Five-year ("Sunset") Reviews of Antidumping and Countervailing Duty Orders; Policy Bulletin*, 63 Fed. Reg. 18871, 18875 (April 16, 1998). If the allocated "benefit" stream for a particular non-recurring subsidy continues beyond the sunset period, it is consistent with Article 21.3 to consider that there is a likelihood of continuation or recurrence of the subsidy (until the end of the allocation period for the subsidy). This does not mean, however, that countervailing duties necessarily would continue, as Article 21 also requires an examination of the likelihood of the continuation or recurrence of injury. There certainly is nothing automatic about US likelihood determinations with respect to continuation or recurrence of either a subsidy or injury. Rather, likelihood determinations are based on an examination of the facts and evidence on the record.

15. As to what SCM Agreement provisions reflect an assumption that it is proper to allocate non-recurring subsidies over time, there is Annex IV, paragraph 7, which reads as follows:

> Subsidies granted prior to the date of entry into force of the WTO Agreement, *the benefits of which are allocated to future production*, shall be included in the overall subsidization. (Emphasis added.)

Although Annex IV deals with serious prejudice cases involving Article 6.1(a) of the SCM Agreement, the wording of paragraph 7 makes clear that insofar as the allocation of subsidies is concerned, the drafters did not intend paragraph 7 to be a special rule applicable exclusively to those cases. Instead, the drafters took as a given the notion that the benefits of certain types of subsidies should be allocated to future production - *i.e.*, should be allocated over time - and added paragraph 7 in order to clarify how these types of subsidies figured into the calculation of the *ad valorem* subsidy rate for purposes of Article 6.1(a). The phrase "the benefits of which are allocated" connotes a proposition that is universally applicable, regardless of the context.

16. The United States notes that the allocation of non-recurring subsidies over time is a common practice among Members and has been endorsed by the Informal Group of Experts, as the United States explained in its First Submission (at paragraph 45). Furthermore, the United States and the EC do not disagree on the propriety of allocating non-recurring subsidies over a period of years, nor do they disagree on the propriety of finding a "benefit" during the period of investigation or period of review by reference to the allocated "benefit" stream.

Q.4. In its written reply to written question 6 from the EC, the US explains why it believes that the issue of whether a financial contribution continues to confer a benefit involves an effects test. If this is the case, wouldn't the assessment required by Article 21.3 (i.e., whether the expiry of CVDs would be likely to lead to "continuation" of subsidization) also involve an effects test? Is it possible to determine whether there is a likelihood of continued subsidization without examining whether there is a likelihood of continued benefit?

17. In its response to questions posed by the EC, the United States stated that the EC was implying that investigating authorities had to determine whether there was a continuing competitive benefit to the new owners of a privatized company, such as an ability to undercut competitors, and that this was effectively an effects test. The United States does not believe that the question of whether the expiry of the duty would be likely to lead to continuation of a subsidy involves an effects test. When the United States refers to effects, it is referring to the potential effect of a subsidy on a company's subsequent performance, mainly output and pricing. Nothing in Article 1.1 or Article 21.3 requires this type of analysis.

18. The United States does not believe it is possible to determine whether there is a likelihood of continued subsidization without examining whether there is a likelihood of continued benefit. The United States believes that the type of analysis and considerations described above in response to question 3 would satisfy the inquiry required by Article 21.3. The considerations described do not in any way constitute an effects test.

Q.5. At paragraph 13 of its second written submission, the US attaches significance to the difference between (i) a company and (ii) the owners of

that company. The US asserts that the EC's discussion of the economics of privatization breaks down if one focuses on the company, rather than the owners of the company. At page 37262 of the General Issues Appendix, however, USDOC states that "[a]lthough plainly there is some distinction between a company and its owners, it is a distinction without a difference in the context of privatization." Please comment.

19. In the cited portion of the General Issues Appendix, USDOC was responding to the US domestic industry's argument that *no repayment* of subsidies should be allowed in the context of a privatization transaction. The US domestic industry argued specifically that the monies being paid to the seller - *i.e.*, the government - in the form of the purchase price represent the owner's funds, not the funds of the successor, privatized company. The US domestic industry's point was that the company's financial position had not changed because of the transaction*;* rather, only the new owner's financial position had changed. According to the US domestic industry, repayment should only be allowed if the monies paid to the government somehow were "disgorged" from the company.

20. In response, USDOC first noted that this argument "rest[ed] entirely on the proposition that there is a complete and absolute distinction between a company and its owners." General Issues Appendix, 58 Fed. Reg. at 37261. USDOC stated, however, that "[a]lthough plainly there is some distinction between a company and its owners, it is a distinction without a difference in the context of privatization." *Id.*, 58 Fed. Reg. at 37262. USDOC then explained these statements at some length.

21. Taking a practical approach, USDOC first explained that the US domestic industry's argument placed form over substance. It stated:

> Merely because a company has been incorporated to protect its owners from the company's legal liabilities or for beneficial tax and accounting purposes (or both), it does not follow that the financial condition of the owners is irrelevant to the financial position of the firm. The form in which new owners purchase the government company creates no appreciable difference in how that company will be operated overall. The fact that the owners are shareholders and raise capital to purchase the government-owned company through new share issuings, rather than the company itself taking on debt, does not mean that the owners can be indifferent to the profit margin the company generates, as petitioners assert.

Id. Rather, USDOC continued, "in the real-world marketplace, the owner-shareholders' expectations of a return on their investment cannot be separated from the profitability of the newly privatized company." *Id*. In essence,

> the privatized company now has an obligation to provide to its private owners a market return on the company's full value. The owners will seek to extract a rate of return from their company at least equal to that of alternative investments of similar risk. There is, then, no appreciable difference, as reflected in the marketplace, between the profit-making ability of the company and the owners' realization of a profitable return on their investment in that firm.

> To adopt the petitioners' rationale that only a full repayment by the new company can extinguish past subsidies would create a test that would elevate form over substance and produce incentives for foreign governments merely to alter the form of the privatization to satisfy this artificial distinction. If the Department were to ratify such a test, owners could simply lend the company the money to repay at least some portion of the past subsidies, taking the capital out as loan payments, rather than dividends.

Id.

22. USDOC ultimately took the position that it was reasonable to conclude that, to some extent, the payment made by the owner would be extracted from the company over time. For that reason, USDOC determined that

> a private party purchasing all or part of a government- owned company (e.g., a productive unit) can repay prior subsidies on behalf of the company as part or all of the sales price. Therefore, to the extent that a portion of the price paid for a privatized company can reasonably be attributed to prior subsidies, that portion of those subsidies will be extinguished.

Id., 58 Fed. Reg. at 37262-63.

23. The point of this discussion was to demonstrate that it is appropriate to consider a portion of the sales price to be repayment of prior subsidies, whether that repayment emanates from the company or the owners of the company. In this context, the distinction between a company and its owners is a "distinction without a difference." As explained in response to question 22, below, there are other contexts where the distinction between a company and its owners is not particularly relevant. As also explained in response to question 22, there are still other contexts where the distinction is relevant, as in those cases where USDOC has found that tax credits on dividends benefit owners but not the company or the merchandise produced, manufactured, or exported by the company.

24. What all of these examples show is that, when these complex questions arise about whether a government practice benefits the owner, the company, and the merchandise manufactured, produced, or exported by that company, USDOC performs a complete and thorough analysis of all of these issues. Based on that analysis, we determine whether there is a basis for imposing duties. USDOC does not impose countervailing duties unless it determines that a government programme benefits the manufacture, production, or export of the merchandise. By contrast, the EC's arm's length approach concentrates solely on the owner of the company *to the exclusion of* the much more fundamental question of whether there is a benefit on the manufacture, production, or export of the merchandise made by the successor company that is essentially the same company as before the change in ownership. This is the fundamental flaw in the EC's position.

Q.6. Were BSC's Special Steels Business assets acquired by UES, or by the owners of UES? Were the terms of the transaction negotiated by UES, or by the owners of UES? Did the owners of UES pay any price for the BSC assets acquired by UES?

25. The details of this transaction are described in the First US Submission at paragraphs 64-66.

26. The first question asked by the Panel is, were BSC's Special Steel Business assets acquired by UES or by the owners of UES? It would seem that BSC sold its Special Steel Business assets to UES, not the owners of UES, in exchange for shares in UES.

27. The Panel's second question asks whether the terms of the transaction were negotiated by UES or by the owners of UES. As far as the United States knows, the terms of the transaction were negotiated by BSC and GKN, who became the owners of UES as a result of the transaction. It would seem that UES did not negotiate the terms because it did not exist until the transaction was consummated.

28. The Panel's last question asks whether the owners of UES paid any price for the BSC assets acquired by UES. The answer here would seem to be no. The BSC assets were the price that BSC paid for its shares in UES. To the extent that UES itself (as opposed to the owners of UES) could be considered to have paid a price for these assets, the price was the shares that BSC received in UES, *i.e.*, a 50 per cent share in UES.

Q.7. At paragraph 20 of its second written submission, the US asserts that neither Articles 1 nor 14 "is intended as an indication of whether the financial contribution will benefit the `legal person' who received the financial contribution". The Panel notes that Article 14 (b) provides that a government loan confers a benefit when "the firm receiving the loan" receives the loan on terms more favourable than a comparable commercial loan. A similar approach is adopted in Article 14(c). Furthermore, the chapeau of Article 14 refers to benefit to the "recipient". Do these provisions not support the view that Article 14 focuses on benefit to the legal person, by determining whether the legal person received government assistance on terms more advantageous than those it could have obtained on the market?

Furthermore, the US explained at paragraph 80 of its first written submission that equity infusions to BSC conferred a benefit because BSC was unequityworthy. Does this not support the view that the US determined benefit to BSC, i.e., the legal person, by determining whether BSC obtained equity on terms more advantageous than those it could have obtained on the market?

29. As the United States has previously acknowledged, as a practical matter, there must be some entity or individual that receives the Article 1.1 financial contribution. Although Articles 14(b) and (c) state that it is a "firm" that receives a loan or loan guarantee, this by itself does not mean that the Article 1.1 "benefit" is a benefit to the recipient "firm." It is a separate question as to who or what is the beneficiary of the financial contribution. Article 1.1 is silent on this matter, as is Article 14.

30. Elsewhere, Article VI:3 of GATT 1994 and Article 10 of the SCM Agreement provide that the purpose of imposing countervailing duties is to offset subsidies bestowed on the manufacture, production or export of the merchandise.

In other words, these provisions contemplate that a subsidy benefits the manufacture, production or export of merchandise.

31. As to the reference in Article 14 to the "benefit to recipient" measurement standard, several observations can be made.

32. Under the SCM Agreement, it is contemplated that Members can use either of two (and possibly more) basic approaches in measuring subsidy benefits. One is the "benefit to recipient" approach, and the other is the "cost to government" approach. Article 14 itself sets out the basic guidelines for an investigating authority's use of the "benefit to recipient" approach.

33. Contrary to an assertion made by the EC at the second panel meeting, the United States does not agree that Article 14 *requires* Members to use the "benefit to recipient" approach for purposes of measuring subsidy benefits in countervailing duty proceedings. Article 14 merely states that, if an investigating authority uses this approach, it must comply with the guidelines in Article 14. The only express requirement in the SCM Agreement regarding the use of one approach or another for purposes of subsidy measurement is found in Part III, which deals with proceedings where one Member challenges an actionable subsidy of another Member in a proceeding before the WTO. Specifically, Annex IV requires the use of the "cost to government" approach for purposes of calculating the *ad valorem* percentage under Article 6.1(a) and establishing a presumption of "serious prejudice."

34. The use of the term "benefit to recipient" in Article 14 should be understood primarily as a contrast to the term "cost to government" in Annex IV. These two approaches deal with competing views on how best to measure subsidy benefits. Under the "cost to government" approach, which the EC followed prior to the entry into force of the SCM Agreement, a subsidy generally is measured on the basis of what it would have cost the government to raise the funds to provide the subsidy. Under the "benefit to recipient" approach, which is the United States' longstanding measurement standard, the focus is on how much the firm benefited from the subsidy, which normally is the difference between the cost to the firm of obtaining the funds from the government and what it would have cost the firm to raise the funds itself in the marketplace.

35. Notably, the term "benefit to recipient" pre-dates the SCM Agreement. It has long been used by USDOC as a short-hand reference to its measurement standard. USDOC uses this term even though it always evaluates a subsidy in the context of whether there is a benefit to the manufacture, production or export of merchandise. The United States further notes that, outside of the privatization/successorship context, there is usually not a question of whether there is a distinction between the company and the merchandise it produces. The two are usually treated as one and the same.

36. For all of these reasons, the Panel should not read too much into the term "benefit to recipient" in Article 14, especially since other relevant provisions, such as Article VI:3 of GATT 1994 and Article 10 of the SCM Agreement, expressly convey the notion that a subsidy benefits the manufacture, production or export of merchandise rather than the subsidy recipient. Instead, as a review of the entire SCM Agreement shows, the SCM Agreement simply does not treat the

nature or identity of the actual subsidy recipient as a significant matter. Indeed, one way to view the actual recipient of a subsidy is merely as a conduit by which a subsidy benefits the manufacture, production or export of merchandise.

37. The subsidy recipient itself should not be the focus of the inquiry envisioned in the SCM Agreement, especially if a legalistic, corporate law identity like that advocated by the EC were used to define the subsidy recipient. If it were, countless creative legal schemes could be devised to avoid the disciplines of the SCM Agreement. In USDOC's experience, USDOC has seen privatizations, partial privatizations, private-to-private transactions, spin-offs of company divisions, "spin-ins" of company divisions, sales of productive units, sales of shares, sales of assets, corporate restructurings and countless hybrid transactions too complex to describe. Even if these transactions are considered to create "new" companies under some version of corporate law, the investigating authority's analysis cannot stop there. Rather, the task of the investigating authority is to determine whether the financial contribution originally provided to the subsidy recipient continues to benefit the manufacture, production or export of merchandise after a change in ownership occurs. Investigating authorities can make this determination by analyzing whether the successor company or productive unit is essentially the same as the prior company.

38. The Panel's last question is whether USDOC's equityworthiness determination supports the view that USDOC, in the administrative reviews at issue, determined a "benefit" to BSC. The United States answers this question with the following observations.

39. First, it should be understood that USDOC determined that the UK Government equity infusions into BSC conferred a benefit by comparing those infusions to the appropriate market benchmark. The analysis of whether BSC was equityworthy at the time of the infusions aided USDOC in making this determination. Where, as here, a market price for the shares purchased by the government was not available, USDOC conducts a test to determine whether the company at issue was "equityworthy" at the time that the government purchased the shares. Under this test, if the company were deemed equityworthy - *i.e.*, if it appeared capable of generating a reasonable rate of return within a reasonable period of time - the government infusion of equity through the purchase of the shares would not confer a benefit. A finding that the company was "unequityworthy" would mean that the government's investment was inconsistent with the usual investment practice of private investors, and USDOC would find a benefit conferred.

40. None of this, however, even remotely suggests that investigating authorities are not to determine whether there is a benefit on the manufacture, production, or export of the merchandise. Almost all subsidy analyses must be performed from the point of view of the company, or even in some sense from the point of view of the principals of the company. Clearly, merchandise cannot pay interest, buy equity, receive loan guarantees, or purchase inputs. If one were to draw a sharp, literal distinction between the recipient, as the company itself or a live person, and the merchandise produced, one would not need a change in ownership to claim that the merchandise did not receive a benefit. As stated above, in the overwhelming majority of cases, there is not a question as to whether there is

a distinction between the company and the merchandise produced by that company. When there is a change in ownership, investigating authorities can determine whether the successor company is essentially the same as the prior company. If so, it is reasonable to conclude that the merchandise produced by the successor company continues to benefit from prior subsidies.

Q.8. Please comment on the argument at paragraph 49 of the EC's second submission that "[t]he US countervailing duty statute recognizes that [a] subsidy exists when a financial contribution is provided `to a person' and a benefit is thereby conferred." (footnote omitted)

41. The EC misstates US law through its argument at paragraph 49 of its Rebuttal Submission.

42. The US countervailing duty statute, in Section 771(5)(B) of the Tariff Act of 1930, as amended, 19 U.S.C. § 1677(5)(B), states that a "financial contribution" is provided to a "person." This does not mean that the "benefit" conferred by the "financial contribution" is also necessarily a "benefit" to the "person".

43. As explained previously, in the context of the SCM Agreement, there must be, as a practical matter, some entity or individual that receives the Article 1.1 financial contribution. However, this by itself does not mean that the Article 1.1 "benefit" is to that recipient entity or individual. In fact, Article 1.1 itself is silent regarding who or what is the beneficiary of a subsidy. Article VI:3 of GATT 1994 and Article 10 of the SCM Agreement, meanwhile, provide that the purpose of imposing countervailing duties is to offset subsidies bestowed on the manufacture, production or export of the merchandise. In other words, these provisions contemplate that a subsidy benefits the manufacture, production or export of merchandise.

44. Consequently, in the change-in-ownership context, USDOC essentially looks at the operations of a company, as is explained below in response to question 25. Basically, if USDOC finds that the entire company has been sold, or that enough of the company's operations to constitute a "productive unit" have been sold, USDOC will allocate the prior subsidies to the company or productive unit after the change in ownership, subject to any repayment deemed to occur under USDOC's methodology.

45. Section 771(5)(B) is entirely consistent with the position that the United States has taken in this dispute under the SCM Agreement. Section 771(5)(B) states nothing more than that the "financial contribution" is provided to a "person". It does not further state that the "benefit" is to that "person".

Q.9. Please comment on the argument at paragraph 48 of the EC's second written submission that "[t]he fact that recipients of subsidies must be persons rather than goods is confirmed by the text of Article 2.1 ASCM, which lays down the fundamental requirement of specificity of the subsidy to certain enterprises …".

46. The EC's argument at paragraph 48 of its Rebuttal Submission misinterprets Article 2.1, the "specificity" provision in the SCM Agreement.

47. Article 2.1 uses the terms "enterprise" and "industry" simply as an aid in determining whether a government is limiting its largesse to certain sectors of the economy. Subsidies that benefit all industries, for example, are not countervailable. Subsidies limited to certain sectors are potentially countervailable.

48. The United States notes that although USDOC itself normally uses the terms "firm" and "enterprise" interchangeably in its practice, it does not wholly clear that Article 2.1 necessarily intends "enterprise" to mean "firm." The term "enterprise" means a "design of which the execution is attempted*;* a piece of work taken in hand, an undertaking ..." or "engagement in such undertakings," according to the Compact Edition of the Oxford English Dictionary (Oxford University Press 1971).

49. Certainly, at a minimum, there is no basis for equating the term "enterprise" in Article 2.1 with the corporate law term "legal person," as the EC is suggesting.

50. Meanwhile, nothing in Article 2.1 conflicts with the United States' interpretation of Article VI:3 of GATT 1994 and Article 10 of the SCM Agreement as providing that the purpose of imposing countervailing duties is to offset subsidies bestowed on the manufacture, production or export of the merchandise, or in other words, that these provisions contemplate that a subsidy benefits the manufacture, production or export of merchandise.

51. Finally, the United States notes that, contrary to the implication in the EC argument quoted by this question, USDOC does not view the Article 1.1 financial contribution as being received by the goods themselves. *See* US Oral Statement (2d), paras. 73-78.

Q.10. At paragraph 17 of its second written submission, the US notes that "the SCM does not expressly address the matter of who or what receives the financial contribution." The Panel notes that Annex I (a) of the SCM Agreement refers to "[t]he provision by governments of direct subsidies to a firm or an industry …". Please indicate whether and why this extract from Annex I(a) does or does not have any bearing on whether the SCM Agreement expressly addresses the matter of who or what receives the financial contribution.

52. Looking at Annex I(a)'s reference to the provision of subsidies "to a firm *or industry*," it appears that Annex I(a) is not attempting to shed light on who or what is the actual recipient of the financial contribution. It arguably could have been construed as addressing the recipient if it only referred to "a firm." But, the additional reference to an "industry" suggests that Annex I(a) is not intended to address the issue of the recipient.

53. As explained previously, the more basic point is that, as a practical matter, there must be some entity or individual that receives the Article 1.1 financial contribution. However, even if this entity could be construed as a "firm" or an "industry" by virtue of Annex I(a), that fact by itself would not mean that the Article 1.1 "benefit" is to that recipient firm or industry. It is a separate question as to who or what is the beneficiary of the financial contribution. Article 1.1 is silent on this matter. Article VI:3 of GATT 1994 and Article 10 of the SCM

Agreement, meanwhile, provide that the purpose of imposing countervailing duties is to offset subsidies bestowed on the manufacture, production or export of the merchandise. In other words, these provisions contemplate that a subsidy benefits the manufacture, production or export of merchandise, which is the United States' position.

54. By referring to a subsidy being provided to "a firm *or industry*," it appears that Annex I(a) is more likely reflecting the notion found elsewhere in the SCM Agreement that a subsidy is considered to benefit the manufacture, production or export of merchandise. What both a firm and an industry have in common is that they carry on business activities, *i.e.*, they manufacture, produce or export merchandise. Arguably, it is those business activities to which, according to Annex I(a), a subsidy is provided.

55. The United States notes that other paragraphs of Annex I more expressly seem to reflect this focus on the manufacture, production or export of merchandise. *See* Annex I(d), (f), (g), (h) and (i).

Q.11. With regard to its written reply to written question 10 from the EC, please explain in detail why the US "expects that USDOC would not consider the successor, privatized company to be a new exporter"

56. In its question, the EC posits that a government-owned company has been a respondent in a countervailing duty investigation and the investigating authority has imposed duties, and then the company is subsequently privatized. The EC then asks if the successor privatized company would be entitled to an expedited, new exporter review under Article 19.3.

57. As a preliminary matter, the United States notes that, in the area of new exporter reviews, the SCM Agreement simply does not provide direct guidance regarding how an investigating authority is to determine whether a new exporter exists. Article 19.3 is silent. Consequently, the likely USDOC approach outlined below should not be viewed as required by the SCM Agreement, and conversely any different approach advocated by the EC in this dispute should not be viewed as necessarily precluded by the SCM Agreement.

58. It is difficult for the United States to explain in detail how USDOC would handle the situation described in the EC's question for the simple reason that USDOC has never addressed this situation. That being said, the United States expects that USDOC would address this situation in the same manner that it would address a change in ownership that took place prior to a countervailing duty investigation. Thus, the United States expects that USDOC would act consistently with the SCM Agreement's focus on the manufacture, production or export of merchandise and, because the operations of the company are essentially the same both before and after the change in ownership, would find that the successor, privatized company is not a new exporter.

59. Furthermore, in the United States' view, the new exporter provision of Article 19.3 is intended to apply in situations where a company only began to produce and export the investigated product after the countervailing duty investigation, a company that previously only produced for domestic consumption has begun to export since the countervailing duty investigation, or a company pro-

ducing and exporting the investigated product was not a respondent in the countervailing duty investigation because there were too many companies for the investigating authority to investigate. The Article 19.3 new exporter provision is not intended to apply in situations like those involved in this dispute, where the ownership of an investigated company (or a productive unit of an investigated company) has changed hands since the countervailing duty investigation, given that in these types of situations the company's operations have not really changed.

60. The United States notes that the EC, in its practice, apparently agrees with this view. For example, in *Thermal Paper from Japan*, OJ EC No. L 232/1 (Sept. 13, 1993), in the anti-dumping context, the European Commission found that the sale of an exporter to a new owner had no effect on that exporter's dumping margin.

61. The United States also notes that a major company within the EC, the French company, Usinor Sacilor, did not request a new exporter review, despite the fact that it was privatized in 1995, two years after the issuance of USDOC countervailing duty orders imposing duties in excess of 10 per cent on lead bar imports and certain steel imports. Consistent with the above analysis, this may suggest that it did not even occur to Usinor Sacilor that it might be eligible for a new exporter review simply because a new owner had taken over.

Q.12. With regard to its written reply to written question 11 from the EC, the US notes "that the EC has not raised any claims in this dispute under Article 21.2 of the SCM Agreement". What is the purpose of this note, in light of the EC's claim under Article 10? Does the US suggest that the administrative reviews at issue may only be challenged under Article 21.2 of the SCM Agreement?

62. In this dispute, the United States is not suggesting that the administrative reviews at issue can only be challenged under Article 21.2. The United States is only suggesting that, to the extent that the Panel might be inclined to find that USDOC somehow violated Article 21.2, which USDOC did not, the Panel is precluded from doing so because the EC made no claims under Article 21.2. The EC's mere invocation of Article 10 does not mean that any and all violations of SCM Agreement provisions in the countervailing duty context are somehow considered to be alleged. The Appellate Body has been clear that the specific relevant provision must be alleged in the complaining Member's panel request for a violation to be found. See *India - Patent Protection for Pharmaceutical and Agricultural Chemical Products*, WT/DS50/AB/R, Report of the Appellate Body adopted 16 January 1998, at paragraph 88-91; and *European Communities - Regime for the Importation, Sale and Distribution of Bananas*, WT/DS27/AB/R, Report of the Appellate Body adopted 25 September 1997, at paragraph 141.

Q.13. In Canada Aircraft (WT/DS70/R) the Panel examined (at paras. 9.232 - 9.246) whether the sale to Bombardier by the Ontario Space Corporation of a 49 per cent interest in de Havilland Inc. constituted a subsidy. In determining that the sale did not confer any "benefit" on Bombardier, the panel did not refer to prior subsidies bestowed on de Havilland Inc. prior to the change-in-ownership. The Panel is aware that this case did not concern

the imposition of CVDs on imports from a privatized company. Nevertheless, does the US consider that the Panel should have taken prior subsidies bestowed on de Havilland Inc. into account? Does the US consider that the panel should have found that prior subsidies to de Havilland Inc. passed through to Bombardier? Why, or why not?

63. Technically, the panel in *Canada Aircraft* should not have taken prior subsidies bestowed on de Havilland Inc. into account because the complaining Member did not make any claim addressing previously bestowed subsidies.

64. The United States further addresses this question below in response to question 2 of the Panel's questions dated 16 July 1999.

Q.14. At paragraph 131 of its first written submission, the US sought to demonstrate the "irrational results" of the EC's approach to change-in-ownership by invoking a trading house hypothetical. During the first substantive meeting, the US pursued this hypothetical further by replacing the trading house with an unrelated importer in the importing country. At the first substantive meeting, the EC responded that its approach would not produce irrational results in such circumstances, because an investigating authority would still be able to determine whether subsidies were bestowed on the producer whose goods are sold by the trading company / unrelated importer. The EC's response to the US trading house / unrelated importer hypothetical is explained further at paras. 93 and 94 of its second written submission. Please comment on the EC's response to the US trading company / unrelated importer hypothetical.

65. In its argument in response to the trading company/unrelated importer hypothetical, the EC refuses to address, or perhaps simply misunderstands, the United States' point.

66. The United States assumes for the sake of argument that it is correct to use the EC's *economic* approach to analysing the possible pass-through of prior subsidies following a change in ownership. The United States then applies this same economic approach to scenarios involving a trading company and an unrelated importer to show how it would lead to absurd results if actually adopted by the Panel. The EC's response wholly ignores the assumption that the scenarios involving a trading company and an unrelated importer are being analysed by the United States from the perspective of the EC's own *economic* approach in order to assess whether or not that approach makes any sense. Instead, to rationalize these scenarios, the EC abandons its *economic* approach and instead reverts to what it should have been using all along in this dispute, which is a *legal* approach under the provisions of the SCM Agreement, and argues that the absurd results described by the United States would not occur. It remains clear, however, that the absurd results noted by the United States *do* occur if the *economic* approach advocated by the EC in this dispute *is* applied to the hypothetical scenarios involving a trading company and an unrelated importer. If, as the EC maintains, an arm's length, fair market value transaction cuts off the prior subsidies because the new owner of the subsidized company has paid what that company, including its subsidies, were worth and therefore receives no benefit, the same rationale means that the prior subsidies are cut off when a trading company or unrelated importer

pays a market price for the subsidized merchandise, including any subsidies benefiting it.

67. The point of these hypothetical scenarios is to demonstrate that there is no economically principled distinction between the EC's basic position in this dispute and the hypothetical scenarios proffered by the United States. If the EC is correct that countervailing duties can only be imposed to offset the continuing benefit from a subsidy as demonstrated by current circumstances (as opposed to by reference to the allocated "benefit" stream), then an arm's length, fair market value sale of a manufactured product (to a trading company or an unrelated importer) cuts off that benefit exactly to the same extent that an arm's length, fair market value sale of a subsidized company does.

Q.15. Please comment on the argument at paragraph 49 of the EC's second submission that "[i]f the subsidy recipients were assets owned by the company at the time it received the subsidy, no amount of the subsidy benefit could logically be apportioned to an after-acquired productive unit."

68. First of all, the premise of the EC's argument is incorrect. The subsidy recipient is not the company's assets, nor has the US made that argument. As the United States has explained previously (*see*, *e.g.*, US Oral Statement (2d), paras. 29-37), as a practical matter, there must be some entity or individual that receives the financial contribution. That is the subsidy recipient, not the assets. It is a separate question as to who or what the beneficiary is. Article VI:3 of GATT 1994 and Article 10 of the SCM Agreement suggest that a subsidy benefits the manufacture, production or export of merchandise, as the EC has conceded.

69. If the erroneous premise is removed from the EC's argument, a proper assessment of whether any amount of the subsidy benefit could be apportioned to the after-acquired productive unit would involve, first, a determination of whether the subsidy at issue is tied or untied, at least under USDOC's practice. If, for example, the subsidy at issue were an untied one, the USDOC would treat it as benefiting the firm's entire operations. Consequently, when the firm acquires an additional productive unit after receiving the untied subsidy, that subsidy would be treated by USDOC as benefiting the new productive unit as well, regardless of whether that productive unit involves a new product line, given that it has become a part of the firm's entire operations.

70. The United States notes that, in this area as well, the SCM Agreement provides no direct guidance, and therefore it cannot be said that the SCM Agreement *requires* one particular approach.

Q.16. In its written reply to written Panel question 9, the US "rejects the notion that subsidies 'attach' to assets or to companies …" In the 1995 administrative review at issue, USDOC stated that "when BSC sold its Special Steels Business, that productive unit took a portion of the benefits with it." Is USDOC's statement consistent with the abovementioned extract from the US response to written Panel question 9? If so, please explain how. Furthermore, please explain how the Special Steels Business "productive unit

took a portion of the benefits with it" if those "benefits" were not attached to that "productive unit".

71. The use of the phrase "took a portion of the benefits with it" in the 1995 administrative review of UK lead bar imports should be understood as a metaphor. It does not literally mean that the company or the productive unit physically carried some of the subsidy benefits with it somewhere when it was purchased by a new owner.

72. In the United States' view, subsidies do not attach to companies, productive units or assets. Rather, subsidies benefit the manufacture, production or export of merchandise, as can be seen from Article VI:3 of GATT 1994 and Article 10 of the SCM Agreement.

73. In its practice, USDOC gives effect to Article VI:3 of GATT 1994 and Article 10 of the SCM Agreement, in the change-in-ownership context, by examining whether the operations of the company or the productive unit, as the case may be, are essentially the same both before and after the change in ownership, as is explained above in response to question 8 and below in response to question 25. Basically, if USDOC finds that the entire company has been sold, or that enough of the company's operations to constitute a "productive unit" have been sold, it will allocate the prior subsidies to the company or productive unit after the change in ownership, subject to any repayment deemed to occur under USDOC's methodology.

74. USDOC's methodology is essentially an exercise in the allocation of subsidies, and in this area the SCM Agreement does not mandate a particular approach. What is needed is a reasonable approach, and that is what USDOC has developed.

Q.17. In the context of the privatization of government-owned assets, the Panel understands that the reason why USDOC considers it necessary to apply its change-in-ownership methodology is because "a private party purchasing all or part of a government-owned company (e.g., a productive unit) can repay prior subsidies …" (GIA, page 37262). A similar statement was made in the US written reply to the Panel's written question 8. Is this understanding correct? If not, please explain why USDOC applies its change-in-ownership methodology in the case of (full or partial) privatization.

In its written reply to written question 12 from the Panel, the US asserted that the USDOC change-in-ownership methodology would apply when privately-owned assets are sold to private companies, but that any subsidies bestowed on the assets before sale would not be repaid through the sale ("because the seller is not the government"). What is the justification for applying the change-in-ownership methodology in the case of a transaction between two private parties? Presumably, USDOC does not do so because of the potential repayment of subsidies.

75. The Panel's understanding of the repayment component of USDOC's methodology is generally correct.

76. USDOC addresses this issue in Exhibit USA-6, which is the Final Results of Redetermination Pursuant to Court Remand in *Inland Steel v. United States*,

Consol. Court No. 93-04-00234 (CIT), dated Oct. 12, 1993. There, in response to an argument made by the petitioning US domestic industry, USDOC explained that its change-in-ownership methodology is essentially an allocation methodology, with technical "repayment" to the government taking place only when the government-owned company is sold in its entirety. Specifically addressing statements about repayment in the General Issues Appendix, USDOC stated:

> In its discussion of subsidy allocation in the *Certain Steel* General Issues Appendix, the Department did not intend the term "repayment" to be construed as narrowly as it has been by petitioners. We wish to clarify that the Department used the term "repayment" in *Certain Steel* in a broader context to include situations where subsidies are "allocated" between the seller and the entity being sold.
>
> When a productive unit is sold by a company which continues to operate (such as BSC), the potentially allocable subsidies which could have travelled with the productive unit, but did not because they were accounted for as part of the purchase price, simply stay with the selling company. As such, they have not been extinguished. Instead, they continue to benefit the seller and our calculation represents the allocation of the subsidies between the seller and the productive unit it has sold. However, when productive units are bought outright from the government itself, leaving no remaining government-owned company which can manufacture or produce (as in the privatization of BSC), then subsidies may be extinguished as the result of the sale. Under this scenario, the buyer is actually making a "repayment" to the government which potentially can extinguish subsidies.

Id., pages 5-6.

77. Thus, in the context of a *full* privatization, USDOC applies its change-in-ownership methodology first by apportioning the prior subsidies between the seller, i.e., the government, and the successor, privatized company. Because the seller is the government, USDOC then deems the portion allocated to the seller as the repayment of subsidies.

78. In the case of a *partial* privatization - which USDOC defines as a sale of less than the entire ownership interest in a government-owned company, such as the sale of a 40 per cent of the shares of that company - USDOC follows same approach that it uses for a full privatization, based on the same considerations, except that USDOC's methodology is only applied to the percentage of the ownership interest sold. An example of how the methodology would work in this situation can be seen from the US response to question 2 of the Panel's questions dated 16 July 1999.

79. In the case of a spin-off of a productive unit of a government-owned company, USDOC technically does not treat it as a type of privatization. Here, there is no possibility of repayment of the prior subsidies to the government because the seller is not the government; rather, the seller is a government-owned company which continues its remaining operations. Nevertheless, USDOC follows the same basic approach that it uses for privatizations. It apportions the prior

subsidies between the surviving government-owned company and the sold productive unit, now under new ownership. However, at that point, its analysis is over. USDOC does not proceed to deem the portion of the prior subsidies allocated to the surviving government-owned company - the seller - to be a repayment to the government itself. Rather, it treats this portion as continuing to benefit the surviving government-owned company.

80. In the case of a purely private change in ownership, USDOC follows the same approach that it uses for spin-offs, based on the same considerations.

81. Stated differently, when the entire government-owned company is being sold, or a partial ownership interest in a government-owned company is being sold, the part of the purchase price considered paid to the seller on account of previously bestowed subsidies is paid to the government, so that the subsidies are considered to be "repaid" to the government. When the seller is not the government but rather the government-owned company or a private company, the part of the purchase price considered paid on account of previously bestowed subsidies is simply considered to be "payment for" those subsidies.

82. The United States notes that the evolution of USDOC's practice in the change-in-ownership area - where USDOC first applied its methodology to a full privatization and then to partial privatizations and purely private changes in ownership - is detailed in Exhibit USA-10, the *Delverde* remand determination, at pages 11-20.

Q.18. If privatization (full or partial) can lead to (full or partial) termination of prior subsidies bestowed on the privatized company (see US written response to written question 4 from the Panel), is the subsidy terminated because there is no longer any government "financial contribution", because there is no longer any "benefit", or because there is no longer both "financial contribution" and "benefit"? If the subsidy is terminated because there is no longer any "benefit" (irrespective of whether or not the "financial contribution" remains), is it correct to state that there is no re-identification or re-valuation of the original "benefit" (see, for example, paragraph 19 of the US second oral submission)?

83. Turning to the Panel's first question, it is not so much a question of whether the "financial contribution" remains. The "financial contribution" is an act made at one point in time. Rather, the issue is whether the "benefit" conferred by the "financial contribution" continues to exist or, alternatively, has been terminated. Under USDOC's practice, when a subsidy is repaid in full or in part to the government, the "benefit" is terminated in full or in part.

84. As the Panel's second question states, it is also correct that when accounting for a repayment of subsidies, as the United States explains in its Rebuttal Submission at paragraphs 37-55, USDOC does no more than reapportion the allocated "benefit" stream, which itself was calculated based on events as of the time when the "financial contribution" at issue was made.

85. Thus, in the case of a *full* repayment of subsidies in the change-in-ownership context, USDOC apportions an amount equal to the entire remaining allocated "benefit" stream to the government, and it is this amount that is deemed

to have been paid back to the government. The Article 1.1 "benefit" is considered terminated or withdrawn in its entirety, just as it would be terminated at the end of the amortization period.

86. With regard to a *partial* repayment, the same analysis applies to that portion of the prior subsidies deemed to be repaid to the government. USDOC apportions a part of the allocated "benefit" stream back to the government as partial repayment, and that amount of the "benefit" is considered terminated.

Q.19. At paragraph 50 of its second written submission, the US asserts that "USDOC recognizes repayment by allocating the subsidy `benefit' back to the government." Is the US referring to "benefit" within the meaning of Article 1.1(b) of the SCM Agreement? If so, what is the "benefit" to the government in such circumstances?

87. With regard to the Panel's first question, the United States is referring to the term "benefit" as it is used in Article 1.1.

88. With regard to the Panel's second question, assuming a full repayment of the subsidy, an amount representing the remaining net present value of the allocated "benefit" stream is what is considered paid back to the government. This does not mean, however, that the government somehow has received a "benefit" as contemplated by Article 1.1. Rather, the Article 1.1 "benefit" is considered terminated or withdrawn, without any re-identification or re-valuing of that "benefit," just as it would be terminated at the end of the amortization period.

Q.20. In its written reply to written question 3 from the Panel, the US submits that "[r]ecognizing repayment does not entail re-valuing the subsidy, an exercise which would involve redetermining the original benefit and calculating a new amortization table." Is the subsidy not re-valued when repayment is only partial? Doesn't partial repayment lead to the calculation of a new amortization table?

89. Under USDOC's practice, there is no re-identification or re-valuing of the subsidy benefit when partial repayment occurs. When the subsidy recipient makes a repayment of a prior subsidy, USDOC does not immediately know whether it is a full or partial repayment. USDOC first must calculate the net present value of the remaining allocated "benefit" stream as of the time of the repayment, and then subtract the amount of the repayment from this net present value figure to determine whether there has been a full or partial repayment of the subsidy.

90. If the result of this subtraction is zero (or less than zero) - *i.e.*, if there is nothing left of the calculated net present value of the remaining allocated "benefit" stream - USDOC treats the repayment as a full repayment and the Article 1.1 "benefit" is considered terminated or withdrawn, as explained above in response to questions 18 and 19 and in the United States' Rebuttal Submission at paragraphs 37-55.

91. On the other hand, if the result of the subtraction is greater than zero - *i.e.*, if some amount of the calculated net present value of the remaining allocated "benefit" stream remains, USDOC treats the repayment as a partial repayment

and, therefore, a partial termination or withdrawal of the Article 1.1 "benefit." Here, USDOC takes what is left of the calculated net present value of the remaining allocated "benefit" stream and allocate it over the years remaining in the allocation period. USDOC does this without any "re-identification" or "re-valuing" of the subsidy benefit. Instead, what USDOC is doing is reducing the original allocated "benefit" stream in proportion to the amount of partial repayment. What this means is that the resulting amortization table is the same as the original amortization table, except that for each of the remaining years in the allocation period a constant percentage of the amount originally allocated to each of those years has been apportioned to the government and deemed repaid, while the remaining percentage continues to be apportioned to the subsidized company. USDOC does not consider this reapportionment exercise to constitute re-identification or re-valuation of the subsidy benefit because we do not revisit or re-examine the original programme that gave rise to the subsidy, the legal basis for the receipt of the subsidy, specificity, market conditions at the time of bestowal, market benchmarks, or any other of the many factors that must be examined at the time of the subsidy bestowal in order to determine whether a countervailable subsidy exists.

Q.21. Are there circumstances in which a producer's production may "benefit" from a "financial contribution", without the producer itself "benefiting" from a "financial contribution"? Please explain, and provide examples if relevant.

92. The United States has been unable to identify examples in which a producer's production - meaning the manufacture or production of merchandise - may "benefit" from a "financial contribution", without the producer itself "benefiting" from a "financial contribution." It would seem that if the producer's production is benefiting, the producer itself is benefiting as well. This does not necessarily mean that all of a producer's production receives a benefit from a subsidy. For example, if a subsidy were "tied" to product A and the product under investigation were product B, the producer would be benefiting from the subsidy but the production relevant to the countervailing duty investigation would not be benefiting. Or, if a subsidy were "tied" to services performed by the producer, and those services were unrelated to the product produced by the producer, the producer would be benefiting from the subsidy but the producer's production of merchandise subject to a countervailing duty investigation would not be benefiting. In both instances, USDOC would not find a benefit.

93. The United States notes that, for purposes of this dispute, where all of the subsidies are "untied", there is not much of a practical distinction between an approach which focuses on a benefit to production and an approach which focuses on a benefit to the producer. Either approach supports USDOC's change-in-ownership methodology, which centers on the company's operations, whether it be the operations of a company or a productive unit, before and after a change in ownership. At the same time, either approach wholly undermines the EC's position. As the United States has explained previously, the EC's basic position is that the SCM Agreement *requires* the investigating authority to find that prior subsidies automatically, and in all instances, are cut off by an arm's length, fair market

value transaction, regardless of whether the "new" company is essentially the same as the "old" company. This position is based on the notion that a subsidy can only benefit the owner of a company, without any further analysis of whether the merchandise produced by that company benefits, which is contrary to either a focus on the producer or the producer's production.

Q.22. Smith Ltd., a producer of widgets, is wholly owned by Mr. Smith. The government commits itself to pay Mr. Smith (not Smith Ltd.) $0.02 for every widget sold by Smith Ltd., provided Smith Ltd. cuts its widget resale price by $0.01. Smith Ltd. widgets normally sell for $10.00, of which $1.00 constitutes profit. Does the $0.02 per unit payment to Mr. Smith constitute a subsidy on production by Smith Ltd.? Please explain.

94. Given the facts as stated in the Panel's question, USDOC probably would find a subsidy benefiting the production of widgets. In this regard, regardless of whether Mr. Smith or Smith Ltd. actually receives the subsidy, it would seem that the subsidy is being provided to encourage the production of widgets, given that the government's payments are to be made for every widget sold.

95. The United States notes that USDOC does not always treat financial contributions provided to owners as benefiting the manufacture, production or export of merchandise. For example, where governments exempt from tax the dividends paid by a manufacturer, USDOC normally treats the exemption as benefiting the shareholders but not the manufacturer itself, or the merchandise produced by that manufacturer. *See, e.g.*, *Final Affirmative Countervailing Duty Determination; Ball Bearings and Parts Thereof from Thailand*, 54 Fed. Reg. 19130 (May 3, 1989) ("[T]he taxes are on the parent's dividend income, and the exemption bestows no benefit on respondents [i.e., exporters of subject merchandise] ... ."); *Final Results of Administrative Review of Countervailing Duty Order; Bicycle Tires and Tubes from Korea*, 48 Fed. Reg. 32205 (July 14, 1983) (tax exemption on dividends paid to parent company "would bestow no benefit on the subsidiary").

Q.23. Please comment on the conclusions drawn in paragraph 46 of the EC's second oral submission.

96. In responding to a written question from the EC asking how USDOC found full repayment of subsidies in the countervailing duty investigation of *Stainless Steel Sheet and Strip in Coils from France*, 64 Fed. Reg. 30774 (June 8, 1999), with regard to the sale of Richemont, the United States would first like to point out that it cannot use the actual data from that investigation. That data was submitted by the French company, Usinor, as business proprietary information, and USDOC is therefore precluded by US law from divulging it. However, in an effort to describe how USDOC's calculation nevertheless works in this type of situation, the United States discussed a hypothetical involving £250,000 that resulted in full repayment of the prior subsidies, as in the Richemont transaction. In its Oral Statement at the second panel meeting, the EC criticized the United States for using an allegedly unrealistic hypothetical that results in full repayment of the prior subsidies. The EC then used an extreme hypothetical of its own, os-

tensibly to show that USDOC's change-in-ownership methodology normally results in little or no repayment of prior subsidies.

97. As should be clear, the United States was not presenting its £250,000 hypothetical as representative of the result that normally obtains under USDOC's methodology. It was only using it to demonstrate what did, in fact, happen with regard to the Richemont transaction.

98. At the same time, it should be equally clear that the extreme hypothetical used by the EC is also not representative. Indeed, it is hardly representative of what normally happens under USDOC's methodology, and more importantly, it bears no relation to what happened, as a matter of fact, in the administrative reviews at issue in this dispute. In the first BSC change in ownership, which involved the spin-off of a BSC special steels productive unit to the UES joint venture in 1986, USDOC found *57 per cent* of the prior subsidies (meaning the pro rata portion of the untied subsidies previously received by BSC which were attributable to the productive unit) to have been repaid (in the sense that they were allocated back to the government-owned company, BSC). In the other BSC change in ownership, when BSC itself was fully privatized in 1988, USDOC found *26 per cent* of the prior BSC subsidies to have been repaid to the UK Government. Because the total amount of UK Government subsidies provided to BSC over the years leading up to these transactions was more than *$13 billion*, this was an *enormous* amount of repayment recognized by USDOC.

Q.24. At paragraph 93 of its second oral submission, the US cites to extracts from an article by Mr. Hufbauer. The first paragraph of that extract states that "whether British Steel's new owners benefitted from the prior subsidies has no bearing on the competitiveness of the steel mills - which the subsidies pumped up massively." Please give the full title of the entity described as "British Steel" in this extract. Whose "competitiveness" has been "pumped up". Is it the fact that an entity's "competitiveness" has been "pumped up" that demonstrates the existence of "benefit" within the meaning of Article 1.1(b) of the SCM Agreement?

In his article (Exhibit USA-40), Mr. Hufbauer states that "[a]ssuming British Steel shares were fairly priced, the government's financial position was unchanged by the sale. So how can it have been repaid for the prior subsidies?" We understand Mr. Hufbauer to argue that the privatization of BSC could not have led to the repayment of subsidies conferred on BSC. How is this consistent with the US assertion at paragraph 95 of its first written submission that "[t]he portion [of BSC subsidies] allocated to the UK Government was considered to have been repaid to the government …"?

99. It appears that, when Mr. Hufbauer refers to "British Steel," he means the company both before and after the privatization, which he regards as essentially the same company. He is not concerned with the change in the company's name from British Steel Corporation to British Steel plc, nor is he concerned with the mere fact that the ownership of the company has changed hands.

100. As to whose competitiveness is "pumped up" by the UK Government's massive subsidization, it would seem that Mr. Hufbauer means again that the

competitiveness of the company both before and after the change in ownership is pumped up.

101. Next, the fact that the company's competitiveness has been "pumped up" does *not* demonstrate the existence of a "benefit" within the meaning of Article 1.1(b) of the SCM Agreement, nor does Mr. Hufbauer suggest that it does. The "benefit," as the United States explained in its Oral Statement at the second panel meeting, is the difference between the original financial contributions - here, predominantly equity infusions - and the appropriate market benchmarks, and this "benefit" is found to exist after the change in ownership and, specifically, during the period of investigation or period of review through an examination of the unamortized portion of the allocated "benefit" streams. The allocated "benefit" stream itself is based on an identification and measurement of the subsidy "benefit" as of the time when the financial contribution was made. USDOC's benefit calculation does not attempt to reflect how the subsidy may or may not have affected the competitiveness of the company at any time after the subsidy bestowal.

102. Mr. Hufbauer seems to agree with this view. At the same time he points out that when interpreting and applying the SCM Agreement, it is important not to lose sight of the reason why subsidies are subject to SCM Agreement disciplines in the first place - they misallocate resources and distort production. In particular, Mr. Hufbauer emphasizes that the company is still "pumped up" - in other words, it has not shrivelled up as a result of the privatization - in order to illustrate why the EC's economic attack on USDOC's methodology is misplaced. As he states, the arm's-length, fair market value nature of the transaction does not eliminate the increased competitiveness of the company because it takes nothing out of the company. However, again, he does not suggest that the SCM Agreement actually requires any inquiry into the degree of trade distortion for the purpose of identifying the Article 1.1(b) "benefit".

103. Finally, as to Mr. Hufbauer's argument that no amount of the purchase price in a privatization transaction like that involving British Steel should be considered as a repayment to the government, the relevant point is that Mr. Hufbauer is making an economic argument. USDOC developed its repayment approach largely for other reasons, and not as a simple matter of economics. The United States notes that the SCM Agreement itself does not preclude USDOC from adopting the approach advocated by Mr. Hufbauer*;* rather, USDOC has chosen not to adopt that approach.

Q.25. What does the US mean by the terms "productive assets" and "productive unit"?

104. USDOC adopted the concept of "productive unit" to deal with the many complex types of corporate restructurings and changes in ownership that it encountered in numerous, contemporaneous 1993 countervailing duty investigations involving steel imports from various countries. As explained in the General Issues Appendix, 58 Fed. Reg. at 37268, in order to be considered a "productive unit", a spun-off operation must be capable of (1) generating sales and (2) operating independently.

105. USDOC adopted this broad definition because other definitions were too restrictive to deal with the myriad different factual scenarios and the various legal environments in various countries that USDOC encountered. USDOC avoided concepts such as division, subsidiary, separately incorporated company, or even whether a separate profit center existed. USDOC found that no single term commonly used in the corporate law of the countries involved was sufficient to cover all of the scenarios that it encountered where either a whole company or a part of a company was sold, merged, acquired, transferred, spun off or spun in and yet remained essentially the same operations or part of the same operations as it was before.

106. It makes no sense, in the United States' view, to apply a different countervailing duty analysis simply because the ownership or structure of the subsidized operations has changed hands. USDOC's practice recognizes this by providing that, where new owners take over a company in its entirety, as in the case of BSC/BS plc, a relevant change for countervailing duty purposes has not occurred. The post-privatization company, BS plc, had essentially the same operations as pre-privatization BSC. It had the same facilities, same production, same sales and same workers, among other things.

107. While easier to see in the case where a whole company is sold, the same reasoning applies when a productive unit, such as BSC's Special Steels Business in 1986, is sold. Here, USDOC's practice recognizes that there may be circumstances where an unincorporated division has the characteristics of a company - facilities, production, sales, workers, etc. - and that transferring that division to new owners yields the same result as the sale of an entire company. Pre- and post-1986, the Special Steels Business continued unchanged as a "productive unit" capable of generating sales and operating independently even though its legal status as a corporate division of BSC may have changed. It had the same facilities and produced and sold the same products, with the same workers. (Indeed, BSC did not change the division's operations at all; rather, it just changed the divisions's corporate form and part of its ownership.) This is the essence of USDOC's concept of "productive unit."

108. Meanwhile, the United States has assigned no special meaning to the term "productive assets." The United States has simply used this term to describe the production facilities of a company or division both before and after a change in ownership, as in the company or division "had the same productive assets both before and after privatization."

Q.26. In response to written question 12(d) from the US, the EC asserts that "[w]hether the new producer / exporter which has purchased the assets has obtained a benefit depends, of course, on the terms of the transaction (fair market value, arm's length transaction)." Does this suggest that a "financial contribution" potentially conferring a "benefit" passes through in a change-in-ownership transaction? If not, what could be the relevant "financial contribution" for the purpose of imposing countervailing duties on imported goods produced by the privatized company.

109. As far as the United States can tell, the EC's response suggests that a "benefit" from a previously bestowed subsidy can pass through in a change in

ownership transaction only if the new owner has paid less than a fair market value price for the company. It appears that, according to the EC, the "financial contribution" that could give rise to a "benefit" that passes through to the new owner is the original "financial contribution," made perhaps several years prior to the change in ownership. In the view of the United States, prior subsidies and the potential for a *new* subsidy to be bestowed in the process of a change in ownership are two separate issues.

110. In theory, the United States would agree that the sale of a company at less than fair market value could give rise to a new subsidy (over and above the remaining value of prior subsidies). However, as explained, USDOC's reallocation/repayment methodology does not focus on the arm's length nature of the sales price *per se*. The sales price is relevant in USDOC's calculation in the sense that the higher the price, the more "credit" toward prior subsidies the purchaser would get and, hence, a lower subsidy rate. In the case of the Richemont sale in *Stainless Steel Sheet and Strip from France*, as explained previously, USDOC did not reach the issue of whether a new subsidy was bestowed in the process of the change-in-ownership transaction because it found that the transaction was at fair market value. USDOC treated the issue of a *new* subsidy as separate from the issue of whether prior subsidies continued to benefit the production of the "old" and "new" companies.

111. The EC's response suggests that the exclusive focus under the SCM Agreement is on the new owner of the company following a change in ownership and, specifically, how that new owner receives a benefit. The United States has shown that the owner of a company is not the correct focus under the SCM Agreement, and the EC itself has conceded that the owner should not be the focus.

112. That being said, as the United States pointed out in its Concluding Statement at the second panel meeting, the EC still bases its position in this dispute on an inquiry into whether the *owner* of the company is the same or different following a change in ownership. As we have seen, the EC's final formulation of its position is that any distinction between a sale of shares and a sale of assets is a distinction based on form over substance and therefore is meaningless. According to the EC, it is instead necessary to - it is *required* by the SCM Agreement to - look at the "economic reality" of the transaction to determine whether the company is the same or different following the change in ownership. EC Oral Statement (2d), paragraph 23. The EC, however, never explains how or on what basis an investigating authority is to do this. Instead, the EC says only that an arm's length, fair market value transaction cuts off the previously bestowed subsidies. *See id.*, paragraph 24. However, in the view of the United States, the arm's length nature of the transaction has nothing to do with the "economic reality" of whether the new company is essentially the same as the old company. How can a company be the same or different based solely on the *amount* of the purchase price?

113. It appears, therefore, that the EC is essentially saying that all changes in ownership result in a new company. But, the question that then immediately arises is, on what basis does the EC take this position? What is it in the SCM Agreement that *requires* it? The EC does not say. What is apparent, however, is

that the EC is exclusively focussing on the *owner* of the company, even though the EC maintains that the SCM Agreement does not focus on the owner. *See* EC Rebuttal Submission, paragraphs 42, 43, 47 and 56*;* EC Responses to United States' Questions, responses to questions 3, 4.b., 7, 10, 11, 12, 13, 14 and 24.

114. Consequently, as the United States has previously demonstrated, the EC's position in this dispute is not supported by the SCM Agreement because of its erroneous focus on the owner of the company.

QUESTIONS FOR THE UNITED STATES dated 16 July 1999

Q.1. Let us suppose that there are two companies, company A and company B, that company A received subsidies while company B did not, that company A exports while company B only sells domestically, and that company A was subject to a CVD investigation as a result of which it is subject to CVDs. Suppose that company A trades its assets, or exchanges its whole plant, for the assets (or plant) of company B. Would this mean that company A is no longer liable to CVDs since the assets embodying the benefits received through subsidies are not benefitting its production any more? The Panel assumes that the US would not deal with this situation through the "allocation of the benefit" methodology (the "gamma" ratio) since such situation does not involve a change-in-ownership. Further, what would happen if company A did not receive an asset in exchange, but just cash?

115. As a preliminary matter, the two hypothetical transactions posited by this question appear to be quite unusual, and USDOC certainly has not encountered either of them in its practice. If it were to encounter them, a significant question would be raised as to whether these transactions were shams, or whether they were conducted to evade countervailing duties, in which event USDOC likely would ignore the transactions.

116. Nevertheless, for the sake of argument, the United States is assuming that USDOC would find the transactions to be legitimate and, further, that they involve an asset exchange or a sale of assets that qualifies, at a minimum, as a "productive unit" within the meaning of USDOC's practice. As the United States explained at the second panel meeting, USDOC does not apply its change-in-ownership methodology to a sale of a bare asset that does not rise to the level of a "productive unit." One obvious example is the sale of a typewriter, but it is also true that much more substantial assets, such as a fleet of trucks or a stamping machine, would not necessarily qualify as a "productive unit."

117. With regard to the first hypothetical transaction, USDOC likely would apply its change-in-ownership methodology to it, contrary to the assumption in the Panel's question. For one thing, this transaction would appear to involve a change in the ownership of the assets of the subsidized company, company A. In exchange for company B's assets, the assets of company A now belong to company B. In addition, regardless of whether a change in ownership took place within the meaning of some Member's corporate law, USDOC, like the SCM Agreement, focuses on the operations of a company and its productive assets rather than on corporate law technicalities. Thus, the asset exchange, assuming it

constitutes a productive unit, would be enough to trigger USDOC's methodology. What this would mean is that USDOC would take the allocated "benefit" stream for each of the subsidies previously bestowed on company A and apportion it between company A and company B. Assuming that company A continues to export and company B continues to sell only domestically, company A alone would (continue to) be liable for countervailing duties, although the amount of its liability would have been reduced as a result of the application of USDOC's methodology.

118. With regard to the second hypothetical transaction, which involves a sale of assets for cash rather than an asset exchange, USDOC again would likely apply its change-in-ownership methodology, and essentially the same apportionment of prior subsidies would result. In this case, however, assuming that company A no longer was in business following this transaction, and further assuming that company B continued to sell only domestically, there would not be any exports on which to impose countervailing duties.

Q.2. For the purposes of question 13 to the US (14 July 1999), please assume that the complaining party had included any relevant claims in its request for establishment, and that the existence of subsidies to de Havilland Inc. between 1992 and 1997 had been acknowledged by the respondent Member.

119. In responding to this question, in addition to the assumptions contained in this question, the United States is assuming that the other relevant facts are as follows: Bombardier and the Ontario Government purchased 51 per cent and 49 per cent, respectively, of Boeing's de Havilland division in 1992. Pursuant to a 1992 contract between Bombardier and Ontario regarding this purchase, the parties had agreed to a put/call provision, exercisable by Bombardier or Ontario, contemplating that Ontario would later sell its 49 per cent stake to Bombardier for $49 million. Over the next five years, Ontario provided various subsidies to the new de Havilland entity, de Havilland Inc., thereby increasing the value of the put/call provision. In 1997, Ontario finally did sell its shares to Bombardier, at the price agreed to in 1992.

120. As to whether the panel should have taken the subsidies bestowed on de Havilland Inc. between 1992 and 1997 into account, the answer is yes.

121. Under its practice, when USDOC encounters a sale of the government's ownership interest in a company, as here, it applies its change-in-ownership methodology. Specifically, it applies that methodology to the relevant percentage of the company sold, which in this case is Ontario's 49 per cent share in de Havilland Inc. that was sold to Bombardier. In other words, USDOC would examine 49 per cent of the allocated "benefit" stream of the subsidies previously bestowed on de Havilland Inc. and apportion part of it to de Havilland Inc. and part of it to the seller of the 49 per cent share in de Havilland Inc., which would be considered repaid because the seller is the Ontario Government. In the end, the amount of the previously bestowed subsidies allocated to de Havilland Inc. would include 51 per cent of the allocated "benefit" stream of the previously bestowed subsidies plus that part of the remaining 49 per cent of the allocated "benefit" stream of the

previously bestowed subsidies that was apportioned to de Havilland Inc. through USDOC's change-in-ownership methodology.

122. The United States notes that, in applying its methodology, USDOC does not attempt to determine whether the price paid in the change-in-ownership transaction is a market price, which would otherwise seem to be an issue raised by Ontario's sale of its 49 per cent stake in de Havilland Inc. to Bombardier. Again, the price is relevant in USDOC's calculation in the sense that the higher the price, the more "credit" toward prior subsidies the purchaser would get and, hence, a lower subsidy rate.

CANADA - CERTAIN MEASURES AFFECTING THE AUTOMOTIVE INDUSTRY

Report of the Appellate Body

WT/DS139/AB/R
WT/DS142/AB/R

Adopted by the Dispute Settlement Body on 19 June 2000

Canada, *Appellant/Appellee*
Japan, *Appellant/Appellee*
European Communities, *Appellant/Appellee*
Korea, *Third Participant*
United States, *Third Participant*

Present:
Ehlermann, Presiding Member
Bacchus, Member
Feliciano, Member

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I. INTRODUCTION

1. Canada, the European Communities and Japan appeal certain issues of law and legal interpretations in the Panel Report, *Canada - Certain Measures Affecting the Automotive Industry* (the "Panel Report").[1] The Panel was established

[1] WT/DS139/R, WT/DS142/R, 11 February 2000.

to consider a complaint by the European Communities and Japan with respect to a Canadian measure which provides a duty exemption for the importation of certain automobiles, buses and other specified commercial vehicles ("motor vehicles"). According to the Panel, the Canadian measure consists of the Motor Vehicles Tariff Order, 1998 (the "MVTO 1998") and Special Remission Orders (the "SROs") promulgated by the Government of Canada.[2] Pertinent aspects of the Canadian measure are described in Section II below.

2. The Panel considered claims by the European Communities and Japan that the measure is inconsistent with Article I:1 of the General Agreement on Tariffs and Trade 1994 (the "GATT 1994")[3]; with Article III:4 of the GATT 1994; with Article 2 of the *Agreement on Trade-Related Investment Measures* (the "*TRIMs Agreement* "); with the prohibition on export subsidies under Article 3.1(a) of the *Agreement on Subsidies and Countervailing Measures* (the "*SCM Agreement* "); with the prohibition on subsidies contingent on the use of domestic over imported goods under Article 3.1(b) of the *SCM Agreement*; with Article II of the General Agreement on Trade in Services (the "GATS")[4]; and with Article XVII of the GATS. The Panel Report was circulated to the Members of the World Trade Organization (the "WTO") on 11 February 2000.

3. The Panel concluded as follows: (a) that Canada acts inconsistently with Article I:1 of the GATT 1994; (b) that the inconsistency with Article I:1 of the GATT 1994 is not justified under Article XXIV of the GATT 1994; (c) that Canada acts inconsistently with Article III:4 of the GATT 1994, as a result of the application of the Canadian value added requirements; (d) that the European Communities and Japan failed to demonstrate that Canada acts inconsistently with Article III:4 of the GATT 1994, as a result of the application of the production-to-sales ratio requirements; (e) that Canada acts inconsistently with Article 3.1(a) of the *SCM Agreement*; (f) that the European Communities and Japan failed to demonstrate that Canada acts inconsistently with its obligations under Article 3.1(b) of the *SCM Agreement*; (g) that Canada acts inconsistently with Article II of the GATS; (h) that the inconsistency with Article II of the GATS is not justified by Article V of the GATS; (i) that Japan failed to demonstrate that the import duty exemption under the measure constitutes treatment less favourable accorded to Japanese suppliers of wholesale trade services of motor vehicles than that accorded to like Canadian service suppliers, within the meaning of Article XVII of the GATS; and (j) that Canada acts inconsistently with Article XVII of the GATS by according treatment less favourable to services and service sup-

[2] Panel Report, paras. 2.15-2.35.

[3] Japan argued that the inconsistency with Article I:1 of the GATT 1994 resulted from the treatment of all "motor vehicles", whereas the European Communities restricted its claim under this provision to the treatment of "automobiles". Panel Report, paras. 5.19, 6.9, 6.38 and 10.7.

[4] Japan argued that the inconsistency with Article II:1 of the GATS resulted from the treatment of all "motor vehicles", whereas the European Communities restricted its claim under this provision to the treatment of "automobiles". Panel Report, paras. 5.19, 6.710, 6.716 and 10.7.

pliers of other Members than it accords to its own like services and service suppliers, as a result of the application of the Canadian value added requirements.[5]

4. With respect to its conclusions under Articles I:1 and III:4 of the GATT 1994, and Articles II and XVII of the GATS, the Panel recommended that the Dispute Settlement Body (the "DSB") request Canada to bring its measure into conformity with its obligations under the *WTO Agreement*. Having found that certain production-to-sales ratio requirements, imposed as one of the conditions for determining eligibility for the import duty exemption, are inconsistent with Article 3.1(a) of the *SCM Agreement*, the Panel recommended that Canada withdraw the subsidies within 90 days pursuant to Article 4.7 of the *SCM Agreement*.[6]

5. On 2 March 2000, Canada notified the DSB of its intention to appeal certain issues of law covered in the Panel Report and certain legal interpretations developed by the Panel, pursuant to paragraph 4 of Article 16 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "DSU"), and filed a Notice of Appeal pursuant to Rule 20 of the *Working Procedures for Appellate Review* (the "*Working Procedures*"). On 13 March 2000, Canada filed its appellant's submission.[7] On 17 March 2000, the European Communities and Japan each filed its own appellant's submission.[8] On 27 March 2000, Canada[9], the European Communities and Japan[10] all filed appellees' submissions. On the same day, Korea and the United States each filed a third participant's submission.[11]

6. The oral hearing in the appeal was held on 6 and 7 April 2000. In the oral hearing, the participants and third participants presented oral arguments and responded to questions put to them by the Members of the Division hearing the appeal.

II. THE MEASURE AND ITS BACKGROUND

7. The Canadian measure[12] at issue in this appeal is duty-free treatment provided to imports of automobiles, buses and specified commercial vehicles ("motor vehicles") by certain manufacturers under the Customs Tariff [13], the Motor

[5] Japan argued that the inconsistency with Article II:1 of the GATS resulted from the treatment of all "motor vehicles", whereas the European Communities restricted its claim under this provision to the treatment of "automobiles". Panel Report, para. 11.1.

[6] Japan argued that the inconsistency with Article II:1 of the GATS resulted from the treatment of all "motor vehicles", whereas the European Communities restricted its claim under this provision to the treatment of "automobiles". Panel Report, para. 11.7.

[7] Pursuant to Rule 21(1) of the *Working Procedures*.

[8] Pursuant to Rule 23(1) of the *Working Procedures*.

[9] Pursuant to Rule 23(3) of the *Working Procedures*.

[10] Pursuant to Rule 22 of the *Working Procedures*.

[11] Pursuant to Rule 24 of the *Working Procedures*.

[12] In this Report, we refer to this measure as either the "import duty exemption" or the "measure".

[13] S.C. 1997, c. 36.

Vehicles Tariff Order, 1998 (the "MVTO 1998")[14] and the Special Remission Orders (the "SROs").[15] The conditions under which eligibility for the import duty exemption is determined are set out in the MVTO 1998, the SROs and certain Letters of Undertaking (the "Letters").[16]

8. The MVTO 1998 has its origins in the Agreement Concerning Automotive Products Between the Government of Canada and the Government of the United States of America (the "Auto Pact")[17], which was implemented domestically in Canada by the MVTO 1965 and the Tariff Item 950 Regulations. These legal instruments were replaced by the MVTO 1988 and later by the MVTO 1998. The MVTO 1998 is in effect today.[18]

9. Under the MVTO 1998, the import duty exemption is available to manufacturers of motor vehicles on imports "from any country entitled to the Most-Favoured-Nation Tariff"[19], if the manufacturer meets the following three conditions: (1) it must have produced in Canada, during the designated "base

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[14] Under Canadian law, the MVTO 1998 is a regulation promulgated by the Governor-General-in-Council, on the recommendation of the Minister of Finance, under the authority of the Customs Tariff, S.C. 1997, c. 36, subsections 14(2) and 16. See Panel Report, footnote 24.

[15] The SROs are regulations promulgated by the Governor-General-in-Council, on the recommendation of the Minister of Finance and the Minister of Industry, under the authority of the Financial Administration Act, R.S.C. 1985, c. F-11, s. 23. Ibid., footnote 25.

[16] The Letters were prepared and submitted by the Canadian subsidiaries of four automobile manufacturers to the Canadian Minister of Industry in January 1965 and commit these manufacturers to increase the amount of Canadian value added used by a specified percentage of each manufacturer's market share growth. These four companies were: General Motors of Canada, Ltd., Ford Motors Co. of Canada, Ltd., Chrysler Canada, Ltd., and American Motors (Canada) Ltd. Ibid., paras. 10.92-10.95 and 10.128.

[17] See 4 International Legal Materials, p. 302. The Auto Pact was concluded in 1965. Under Article II(a) of the Auto Pact, Canada agreed to accord an import duty exemption to imports from the United States of certain products listed in Annex A of the Auto Pact. In order to receive the import duty exemption, a company had to meet three conditions set out in para. 2(5) of Annex A: (1) it must have produced in Canada, during the "base year", motor vehicles of the class it was importing; (2) the ratio of the net sales value of its production in Canada to the net sales value of motor vehicles of that class sold for consumption in Canada must have been "equal to or higher than" the ratio during the "base year", and could in no case be lower than 75:100; and (3) the Canadian value added in the company's local production in Canada of motor vehicles must have been "equal to or greater than" Canadian value added in motor vehicles of that class during the "base year". Pursuant to Article V of the Auto Pact, Canada extended the benefits of this import duty exemption to other countries, but the United States did not. Canada also was allowed, under para. 3 of Annex A of the Auto Pact, to designate additional manufacturers as beneficiaries of the import duty exemption, even though the manufacturers did not meet the Auto Pact conditions. The Canada-United States Free Trade Agreement (the "CUSFTA"), which entered into force on 1 January 1989, provides, in Article 1001, for the continued administration of the Auto Pact. 27 International Legal Materials, p. 281. However, pursuant to Article 1002.1 and the Annex to Article 1002.1 of the CUSFTA, the Government of Canada could no longer designate additional manufacturers who would benefit from the import duty exemption. The CUSFTA was suspended with the 1 January 1994 entry into force of the North American Free Trade Agreement (the "NAFTA"), which, under Appendix 300-A.1, allows Canada to maintain the import duty exemption subject to the conditions stipulated in the CUSFTA. 32 International Legal Materials, p. 605.

[18] Panel Report, para. 2.15.

[19] MVTO 1998, Schedule, Part 1, para. 2. In para. 10.160 of the Panel Report, the Panel recalled "that Canada applies an MFN duty on motor vehicles originating in non-NAFTA countries at the rate of 6.1 per cent."

year", motor vehicles of the class imported; (2) the ratio of the net sales value of the vehicles *produced in Canada* to the net sales value of all vehicles of that class *sold* for consumption *in Canada* in the period of importation must be "equal to or higher than" the ratio in the "base year", and the ratio shall not in any case be lower than 75:100 (the "ratio requirements"); and (3) the amount of Canadian value added in the manufacturer's local production of motor vehicles must be "equal to or greater than" the amount of Canadian value added in the local production of motor vehicles of that class during the "base year" (the "CVA requirements").[20]

10. The Panel found that, as a matter of fact, the average ratio requirements applicable to the MVTO 1998 beneficiaries are "as a general rule" 95:100 for automobiles, and "at least" 75:100 for buses and specified commercial vehicles.[21]

11. The MVTO 1998 states that the CVA used by a particular manufacturer shall be calculated based on the "aggregate" of certain listed costs of production, which are, broadly speaking:

- the cost of parts produced in Canada and of materials of Canadian origin that are incorporated in the motor vehicles;
- transportation costs;
- labour costs incurred in Canada;
- manufacturing overhead expenses incurred in Canada;
- general and administrative expenses incurred in Canada that are attributable to the production of motor vehicles;
- depreciation in respect of machinery and permanent plant equipment located in Canada that is attributable to the production of motor vehicles; and
- a capital cost allowance for land and buildings in Canada that are used in the production of motor vehicles.[22]

12. Through the SROs, Canada has also designated certain other companies, in addition to those qualifying under the MVTO 1998, as eligible to import motor vehicles duty-free.[23] Canada promulgated the SROs under the authority of the Financial Administration Act for certain companies that had not met the original conditions of the MVTO 1965.[24] The SROs entitle motor vehicles imported by

[20] MVTO 1998, Schedule, Part 1, para. 1(1), definition of "manufacturer". A list of beneficiaries of the MVTO 1998 is contained in the Appendix to Memorandum D-10-16-3, issued by the Ministry of National Revenue on 10 April 1995. This Appendix lists a total of 33 firms, of which four are identified as automobile manufacturers, seven as bus manufacturers, and 27 as manufacturers of specified commercial vehicles. Panel Report, para. 2.21.

[21] Panel Report, para. 10.182.

[22] Panel Report, para. 2.26; MVTO 1998, Schedule, Part 1, para. 1(1), definition of "Canadian value added", letter (a).

[23] Auto Pact, para. 3 of Annex A; Panel Report, para. 2.3. An administrative memorandum of Revenue Canada lists 63 firms as beneficiaries under the SROs, of which two are identified as automobile manufacturers, five as bus manufacturers, and 59 as manufacturers of specified commercial vehicles. Panel Report, para. 2.31.

[24] Panel Report, footnote 25.

these companies to receive the import duty exemption as long as they meet certain designated conditions. Specifically, the SROs provide for the remission of duties on imports of motor vehicles where conditions relating to certain specified production-to-sales ratio requirements and CVA requirements are fulfilled.

13. With respect to the actual ratio and CVA requirements under the SROs, each SRO sets out specific ratio and CVA requirements to be met by the company receiving the SRO. For ratio requirements, the SROs issued before 1977 set the production-to-sales ratios at 75:100. Since then, almost all SROs have set ratios at 100:100.[25] For CVA, requirements under the SROs range from 40 to 60 per cent, as follows: SROs issued before 1984 stipulate that, during an initial period of one or two years, the CVA must be at least 40 per cent of the cost of production. After that initial period, the CVA should be at least the same (in dollar terms) as in the last 12 months of the initial period; however, the CVA must not, in any case, be less than 40 per cent of the cost of production. For SROs issued after 1984, the CVA shall be no less than 40 per cent of the cost of sales of vehicles sold in Canada, with the exception of the manufacturer CAMI Automotive Inc. ("CAMI"), for which the CVA level is set at 60 per cent.[26]

14. In accordance with its obligations under the CUSFTA, since 1989, Canada has not designated any additional manufacturers to be eligible for the import duty exemption under the MVTO 1998, nor has Canada promulgated any new SROs. Also, the MVTO 1998 specifically excludes vehicles imported by a manufacturer which did not qualify before 1 January 1988.[27] Thus, the list of manufacturers eligible for the import duty exemption is closed.

III. ARGUMENTS OF THE PARTICIPANTS AND THIRD PARTICIPANTS

A. Claims of Error by Canada - Appellant

1. Article I:1 of the GATT 1994

15. Canada argues that the Panel erred in finding that the Canadian measure is inconsistent with the most-favoured-nation ("MFN") provisions of Article I:1 of the GATT 1994. By its terms, Article I:1 prohibits discrimination in the according of advantages based on the origin of products. In Canada's view, the Canadian measure at issue is "origin-neutral"[28] in this sense, and is therefore consistent with Article I:1.

16. Canada submits that none of the previous panel reports addressing the issue of MFN treatment under Article I:1 supports the Panel's concept of a *de facto* violation of Article I:1. The facts of the present case are different from those in previous cases. In this case, motor vehicles imported duty-free into Can-

[25] Panel Report, para. 2.34.
[26] Panel Report, para. 2.33.
[27] MVTO 1998, Schedule, Part 1, para. 3.
[28] Canada's appellant's submission, para. 163.

ada come from numerous countries, and the conditions for receiving the import duty exemption have nothing to do with the origin of those vehicles.

2. *Article 3.1(a) of the SCM Agreement*

(a) Whether the Measure Constitutes a "Subsidy"

17. According to Canada, the Canadian measure does not fall within the definition of "subsidy" in Article 1.1 of the *SCM Agreement*. Canada argues that the appropriate test for whether the measure is a "subsidy" is to apply the text of Article 1.1 of the *SCM Agreement*, in its context, and in the light of the object and purpose of the *WTO Agreement*. With respect to context, the meaning of Article 1.1(a)(ii) is circumscribed by footnote 1 of the *SCM Agreement*. This footnote demonstrates that the waiver of import duties for a product will not always be deemed to be a "subsidy". The key element in determining whether a measure is a "subsidy" is that the amount of the duty waived cannot be in excess of the duty amount accrued. The Canadian measure is analogous to the situation described in footnote 1 of the *SCM Agreement*. As there can never be a duty exemption in excess of the amount of the duty that would have accrued, the duty exemption is not a "subsidy" under Article 1.1 of the *SCM Agreement*.

(b) Whether the Measure is "Contingent … in Law … upon Export Performance"

18. Canada argues that the measure is not contingent "in law" upon export performance under Article 3.1(a) of the *SCM Agreement*. The Panel did not even attempt to demonstrate contingency "on the basis of the words of the relevant legislation". Rather, the Panel resorted to hypothetical "facts". By examining these "facts", the Panel shifted its analysis away from contingency "in law" to contingency "in fact".

19. Canada notes that the Panel found that the import duty exemption is contingent upon exportation because the exemption is conditional on meeting certain production-to-sales ratios. The Panel grouped these ratios into two categories: ratios below one to one, and ratios of one to one or higher. Canada argues that neither of these two categories of ratios results in export contingency "in fact".

3. *Article I:1 and Article II:1 of the GATS*

(a) Article I:1 of the GATS

20. According to Canada, the Panel erred in finding that the scope of the GATS extends to the measure at issue. Canada argues that the scope of the GATS is established in Article I of that Agreement, which states that the Agreement applies to "measures…affecting trade in services." Canada submits that the measure at issue does not affect trade in services. In this case, Canada contends, the measure does not affect the supply of distribution services and does not affect

wholesale distribution service suppliers in their capacity as service suppliers. It is true that the import duty exemption "may affect"[29] the cost of the goods. However, any effect this may have on the supply of distribution services is so "tenuous"[30] that the measure clearly falls within the category of measures that should be scrutinized exclusively under the GATT 1994.

(b) Article II:1 of the GATS

21. Canada submits that the complainants have claimed both *de jure* and *de facto* discrimination under Article II:1 of the GATS. To find for the complainants, the Panel was required to set out the basis on which the measure accords less favourable treatment to certain services and service suppliers, and to show how this less favourable treatment is accorded to the like services or service suppliers of certain Members. In Canada's view, the Panel's analysis does not demonstrate either of these.

22. Canada argues that it appears the Panel found discrimination against services and service suppliers of "any other Member" on the basis that the import duty exemption was granted to *certain* manufacturers of *some* Members, even though the qualification for this treatment was based on "origin-neutral"[31] criteria. This finding is problematic because it implies that unless all manufacturers of all Members satisfy the criteria applied for eligibility for the import duty exemption, discrimination will always be found. Under the Panel's reasoning, there would be discrimination whenever a manufacturer of a Member was not represented among the qualifying service suppliers. Furthermore, Canada states that the Panel's analysis of Article II:1 ignores the fact that the nationality of the manufacturers/wholesalers can be modified by private commercial decisions.

B. Arguments by the European Communities - Appellee

1. Article I:1 of the GATT 1994

23. In the view of the European Communities, the Panel's interpretation of Article I:1 of the GATT 1994 is correct. Although the measure at issue in this case applies to importers and is, on its face, origin-neutral, the Panel found that, nevertheless, such a measure could accord a *de facto* advantage to products originating in certain countries.

24. The European Communities argues that *de facto* inconsistency with Article I:1 of the GATT 1994 must be established on a case-by-case basis. When examining a claim of *de facto* violation, it is necessary to take into account all relevant facts, and infer inconsistency from the total configuration of the facts. In this case, the Panel correctly found that the relevant facts establish that *de facto* inconsistency exists.

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[29] Ibid., para. 115.
[30] Ibid., para. 115.
[31] Ibid., para. 163.

2. *Article 3.1(a) of the SCM Agreement*

(a) Whether the Measure Constitutes a "Subsidy"

25. The European Communities considers that the Panel was correct in finding that the measure constitutes a "subsidy" within the meaning of Article 1.1 of the *SCM Agreement*. Article 1.1(a)(ii) considers as a "financial contribution" the situation in which government revenue that is "otherwise due" is foregone. In this case, the Canadian government established a normative benchmark for its customs duties, which constitute government revenue. The import duty exemption is a departure from this norm. Therefore, the measure constitutes government revenue "otherwise due" that has been foregone and, consequently, is a "financial contribution". As the measure also confers a "benefit" under Article 1.1(b), it is a "subsidy".

(b) Whether the Measure is "Contingent…in Law…upon Export Performance"

26. The European Communities argues that the Panel correctly concluded that the words of the relevant legal instruments demonstrate that the production-to-sales ratio requirements make the measure contingent "in law" upon export performance, in contravention of Article 3.1(a) of the *SCM Agreement*. The standard for *de jure* inconsistency encompasses both legal instruments that provide for *express* export contingency, as well as *implicit* export contingency, that is, where the requirement to export is a necessary consequence arising from the operation of conditions stated in the law. The present case falls into the latter category.

27. In the view of the European Communities, production-to-sales ratio requirements of both one to one or greater, and of less than one to one, result in export contingency "in law". Where the ratio requirements are one to one or greater, the manufacturer concerned cannot sell any value of motor vehicles brought into Canada under the import duty exemption unless it exports an equivalent value. Where the ratio requirements are less than one to one, the European Communities agrees with Canada that the manufacturer concerned is entitled to sell a certain value of motor vehicles imported under the import duty exemption without exporting. However, the European Communities points out that, if the manufacturer does export, the value of imports made under the import duty exemption will increase by an amount equal to the value of the exports. Therefore, the measure is contingent "in law" upon export performance as a result of the ratio requirements, in contravention of Article 3.1(a) of the *SCM Agreement*.

3. *Article I:1 and Article II:1 of the GATS*

(a) Article I:1 of the GATS

28. According to the European Communities, the Panel's finding that the Canadian measure affects trade in services under Article I of the GATS was correct. While it is true that the measure in this case can affect both goods and services,

this does not mean that the measure cannot be examined under the GATS. The European Communities maintains that the proper test under Article I:1 of the GATS is simply whether the measure at issue affects the supply of services and that the Panel's examination of the measure under Article II of the GATS implicitly included an assessment of whether the measure affects trade in services under Article I of the GATS.

(b) Article II:1 of the GATS

29. In the view of the European Communities, Article II of the GATS applies to *de facto* as well as *de jure* discrimination. When examining a claim of *de facto* discrimination, any inconsistency must be inferred from the total configuration of the facts surrounding the measure. In this case, the Panel properly examined these facts, and these facts support its finding that *de facto* discrimination exists.

30. The European Communities submits that the Panel correctly found that the Canadian measure accords less favourable treatment to services and service suppliers of some Members than it accords to like services and service suppliers of other Members. The European Communities argues that, contrary to Canada's claim, vertical integration in the automotive industry does not preclude the possibility that competitive conditions for the provision of wholesale trade services would be affected by the measure. The Panel's finding that vertical integration did not exclude potential competition in wholesaler-manufacturer relationships nor actual competition in wholesaler-retailer relationships was correct. This finding is confirmed by the fact that the vast majority of the service suppliers receiving the import duty exemption under the measure are from the United States. Furthermore, eligibility for the import duty exemption has been closed, since 1989, to any additional service suppliers.

C. Arguments by Japan - Appellee

1. Article I:1 of the GATT 1994

31. Japan maintains that the Panel's finding that the Canadian measure is inconsistent with Article I:1 of the GATT 1994 was correct. The Panel interpreted Article I:1 properly through an analysis of whether the Canadian measure accorded, *de facto*, less favourable treatment to like products of certain WTO Members. The Panel took into account the possibility that the limitation of the import duty exemption under the measure to certain importers resulted in *de facto* discrimination.

32. In Japan's view, the facts of this case demonstrate that the measure is an "advantage" under Article I:1 of the GATT 1994 that is available for imports of motor vehicles originating in some countries, but is not available with respect to imports of like motor vehicles originating in *all* WTO Members. This discrimination arises because eligibility for the import duty exemption is restricted to a limited group of manufacturers, as well as because of the intra-firm purchasing practices of the industry. Accordingly, the Panel properly concluded that the Canadian measure was inconsistent with Article I:1 of the GATT 1994.

2. *Article 3.1(a) of the SCM Agreement*

(a) Whether the Measure Constitutes a "Subsidy"

33. According to Japan, the Panel correctly found that the measure constitutes a "subsidy" within the meaning of Article 1.1 of the *SCM Agreement*. The findings that the measure constitutes a "financial contribution" because government revenue "otherwise due" has been foregone, and that a "benefit" also exists, support the Panel's conclusion that a "subsidy" exists.

(b) Whether the Measure is "Contingent … in Law … upon Export Performance"

34. Japan considers that the measure is contingent "in law" upon export performance under Article 3.1(a) of the *SCM Agreement*. As a result of the ratio requirements, there is a clear relationship of conditionality between the import duty exemption and exportation. Japan argues that where the ratio requirement is set at one to one or higher, there is a requirement to export in order to receive the import duty exemption. The only "economically viable"[32] way for a manufacturer to comply with the ratio requirements when it imports motor vehicles is to export vehicles that it has produced in Canada. Where the ratio requirement is less than one to one, the requirement to export also arises, even though, Japan concedes, the "pressure" to export is of a "lesser degree"[33] in this situation. Japan has provided mathematical expressions of these arguments.

35. According to Japan, the Panel's finding that the ratio requirements, as a condition for receiving the import duty exemption, are contingent "in law" upon export performance was correct, since contingency can be established based on the words of the relevant legal instruments. Those instruments create a "construct"[34] under which the import duty exemption under the measure is contingent upon export performance. Therefore, the measure is contingent "in law" upon export performance under Article 3.1(a) of the *SCM Agreement*.

3. *Article I:1 and Article II:1 of the GATS*

(a) Article I:1 of the GATS

36. In Japan's view, the Panel's approach in determining whether the application of the measure affects trade in services within the meaning of Article I of the GATS is correct. The Panel did not err in its substantive finding that the measure affects trade in services under Article I of the GATS. The term "affecting" in Article I has a broad reach. The measure affects trade in services, as it has an effect on the "cost and/or profitability"[35] of the related wholesale trade services.

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[32] Japan's appellee's submission, para. 71.
[33] Ibid., para. 73.
[34] Ibid., para. 85.
[35] Ibid., para. 113.

(b) Article II:1 of the GATS

37. Japan argues that the measure is inconsistent with the MFN obligation in Article II of the GATS. The Panel's finding in this regard is correct. The Panel relied, in part, on the fact that the measure put some service providers at an economic or competitive disadvantage. The Panel recognized that two elements of the provision of wholesale services must be examined: wholesale services provided to manufacturers, and wholesale services provided to retailers. In Japan's view, the Panel made the correct finding under Article II of the GATS, that the import duty exemption is only available to certain wholesale service suppliers, and is therefore not made available to like service suppliers of all WTO Members.

D. Claims of Error by the European Communities - Appellant

1. Article 3.1(a) of the SCM Agreement - European Communities' Claim Regarding CVA Requirements

38. According to the European Communities, the Panel failed to address the European Communities' claim that the CVA requirements operate as an export performance condition prohibited by Article 3.1(a) of the *SCM Agreement*. The European Communities claimed before the Panel that the CVA requirements make the subsidy contingent "in law" and, alternatively, "in fact" upon the use of domestic over imported goods or, as the sole alternative, upon export performance.[36] Therefore, the CVA requirements are inconsistent with the prohibition of Article 3.1(a). The Panel's failure to address the alternative condition of export performance was an error. The European Communities requests the Appellate Body to find that certain of the CVA requirements are contingent upon export performance.

2. Article 3.1(b) of the SCM Agreement

(a) Whether the Measure is Contingent "in Law" upon the Use of Domestic over Imported Goods

39. The European Communities argues that Article 3.1(b) of the *SCM Agreement* prohibits subsidies contingent upon a condition that "gives preference"[37] to the use of domestic over imported goods. The Panel's narrow finding that Article 3.1(b) only prohibits the granting of subsidies that "require" the beneficiary to "actually use" domestic goods constitutes legal error.[38] In the European Communities' view, the Panel's interpretation would allow circumvention of Article 3.1(b). Furthermore, even applying the test used by the Panel, the CVA requirements do in certain circumstances require the actual use of domestic goods as a matter of law. Therefore, the Panel's finding is in error.

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[36] The claims can be found in the Panel Report, at paras. 6.497-6.500, 6.620 and 6.690.
[37] European Communities' appellant's submission, para. 23.
[38] Ibid., para. 28.

40. The European Communities notes that Article 3.1(b) prohibits the granting of subsidies that are contingent upon the use of domestic over imported goods "whether solely or as one of several conditions". These terms cover the situation where a subsidy is simultaneously subject to two or more "cumulative conditions". However, the European Communities argues that these terms may also apply where a subsidy is subject to two or more "alternative" conditions, where compliance with any one or more of them gives a right to obtain the subsidy.[39] According to the European Communities, the use of domestic over imported goods through the CVA requirements is an alternative condition for receiving the import duty exemption under the measure. This alternative condition is a condition "in law" for receiving the import duty exemption, and is, therefore, inconsistent with Article 3.1(b) of the *SCM Agreement*.

(b) Whether the Measure is Contingent "in Fact" upon the Use of Domestic over Imported Goods

41. In the alternative, the European Communities argues that the CVA requirements constitute a subsidy contingent "in fact" upon the use of domestic over imported goods. In making this claim, the European Communities contends that the Panel's finding that Article 3.1(b) does not apply to "in fact" contingency is erroneous.

42. In the European Communities' view, the Panel's finding was in error as it relied solely on one aspect of the context of Article 3.1(b), while ignoring the ordinary meaning, other contextual aspects, the object and purpose, and the drafting history of the provision. The ordinary meaning of Article 3.1(b) does not exclude contingency "in fact". Also, it is relevant as context that Article 3.1(b) was inserted into the *SCM Agreement* to clarify and reinforce existing GATT 1994 disciplines with respect to local content requirements. Furthermore, the object and purpose of Article 3.1(b) is to prevent the use of subsidies which promote the substitution of domestic for imported goods. If the Panel's interpretation were followed, the prohibitions in Article 3.1(b) could be circumvented.

E. Claims of Error by Japan - Appellant

1. Article 3.1(a) of the SCM Agreement

(a) Whether the Measure is "Contingent … in Law … upon Export Performance"

43. Japan conditionally appeals the Panel's decision not to make a finding with respect to whether the measure is "in fact" contingent upon export performance in contravention of Article 3.1(a) of the *SCM Agreement*. In the event the Appellate Body overturns the Panel's finding that the subsidy is contingent "in law" upon export performance, Japan submits that the Panel's use of judicial

[39] Ibid., para. 44.

economy was in error, and the issue of whether the subsidy is contingent "in fact" upon export performance should be considered by the Appellate Body.

44. According to Japan, the Panel made certain findings relevant to the issue of whether the import duty exemption is contingent "in fact" upon export performance. The Panel's examination of the ratio requirements demonstrates that the "facts" of those requirements lead to the conclusion that the import duty exemption is contingent upon export performance.

2. *Article 3.1(b) of the SCM Agreement*

(a) Whether the Measure is Contingent "in Law" upon the Use of Domestic over Imported Goods

45. Japan argues that the measure is contingent "in law" upon the use of domestic over imported goods, in contravention of Article 3.1(b) of the *SCM Agreement*. The plain language of this provision demonstrates that a "key component" of the applicable legal standard is whether the use of domestic over imported goods "would lead to" the granting or maintenance of a subsidy.[40] This interpretation is supported by the object and purpose of the *SCM Agreement* as a whole and of Article 3.1(b) in particular.

46. Japan submits that, in this case, the use of CVA is one of several conditions that, if fulfilled, results in the receipt of the import duty exemption. One way to meet the CVA requirements is to use domestic parts and materials. According to Japan, it has *not* been demonstrated that the CVA requirements can be met without using domestic parts and materials. The Panel has referred to the *hypothetical* possibility to do so, but Canada has not provided sufficient evidence to rebut the fact that the CVA requirements mandate the use of domestic parts and materials. The Panel's finding that a subsidy is not contingent on the use of domestic over imported goods if it can be obtained through other means, although the use of domestic over imported goods is one way actually to obtain the subsidy, is problematic. If this finding is upheld, it will be possible for WTO Members to escape their Article 3.1(b) obligations by including additional conditions that are unrelated to the use of domestic over imported goods.

(b) Whether the Measure is Contingent "in Fact" upon the Use of Domestic over Imported Goods

47. Japan argues that Article 3.1(b) of the *SCM Agreement* prohibits both subsidies contingent "in law" and subsidies contingent "in fact" upon the use of domestic over imported goods. The Panel's finding restricting the scope of application of Article 3.1(b) to subsidies contingent "in law" was erroneous. The Panel found that the inclusion of the words "in law or in fact" in paragraph (a) of Article 3.1 of the *SCM Agreement* and the absence of the same words in paragraph (b) of the same Article means that the drafters of Article 3.1(b) intended to

[40] Japan's appellant's submission, para. 7.

limit that provision to contingency "in law". In Japan's view, the Panel's reasoning ignores the ordinary meaning of the words of Article 3.1(b). Article 3.1(b) prohibits subsidies "contingent … upon the use of domestic over imported goods." These words do not expressly limit the scope of coverage of Article 3.1(b) to contingency "in law". In the absence of an express limitation, Article 3.1(b) must be interpreted to apply to both contingency "in law" and "in fact". The inclusion of the words "in law or in fact" in Article 3.1(a) is most likely intended to "anchor"[41] footnote 4 of the *SCM Agreement*, which sets forth an explanation of subsidies contingent "in fact" upon export performance. In addition, the Panel's finding that Article 3.1(b) prohibits only subsidies contingent "in law" upon the use of domestic over imported goods does not take into account the object and purpose of the *WTO Agreement* as a whole and of Article 3.1(b) of the *SCM Agreement*.

48. According to Japan, when determining whether a subsidy is contingent "in fact" upon the use of domestic over imported goods, the issue is whether the configuration of the facts surrounding the granting of the subsidy is such that, "in fact", the subsidy will be granted if the recipient used domestic over imported goods. In the case of the measure at issue here, the relevant facts establish that it is impossible for manufacturers to satisfy the CVA requirements without purchasing at least a certain proportion of Canadian parts and components.

F. Arguments by Canada - Appellee

1. Article 3.1(a) of the SCM Agreement

(a) Whether the Measure is "Contingent … in Fact … upon Export Performance"

49. According to Canada, the Panel correctly applied the principle of judicial economy when it declined to examine whether the measure was contingent "in fact" upon export performance under Article 3.1(a) of the *SCM Agreement*. Since the Panel found that contingency "in law" existed, the Panel was entitled to stop its analysis there. This is a legitimate application of judicial economy, which Canada's appeal does not change. However, if the Appellate Body agrees with Canada's contention on the issue of contingency "in law", the question of whether the measure is contingent "in fact" upon export performance will become an issue.

50. With regard to the substance of Japan's appeal, Canada relies on the arguments made in its appellant's submission on this issue. In that submission, Canada argued that there is no evidence to demonstrate that the measure is "in fact" contingent upon export performance.[42]

[41] Ibid., para. 29.
[42] *Supra*, para. 19.

(b) European Communities' Claim Regarding CVA Requirements

51. Canada refers to the argument of the European Communities that the CVA requirements, as a condition for receiving the import duty exemption, are, in the alternative, contingent upon exportation. Canada contends that the European Communities has not identified any error of law in the Panel's decision not to make a finding on this issue. Furthermore, the CVA requirements do not result in a subsidy which is contingent upon export performance, either "in law" or "in fact". Nothing in the text of the measure suggests that the measure is contingent upon export performance, nor is there any factual evidence to show that the granting of the subsidy was in any way tied to exportation, in contravention of Article 3.1(a) of the *SCM Agreement*.

2. Article 3.1(b) of the SCM Agreement

(a) Whether the Measure is Contingent "in Law" upon the Use of Domestic over Imported Goods

52. In Canada's view, the Panel was correct in finding that the measure is not contingent "in law" upon the use of domestic over imported goods under Article 3.1(b) of the *SCM Agreement*. The Panel's interpretation of the word "contingent" was appropriate. By contrast, the European Communities and Japan seek to expand the scope of this term beyond its ordinary meaning. Both complainants argue that Article 3.1(b) of the *SCM Agreement* prohibits any condition that "favours", or gives "preference" to, the use of domestic goods. Canada responds that there is no basis for such an interpretation in the text of Article 3.1(b).

53. Canada submits that the argument by the complainants that Article 3.1(b) prohibits subsidies that may be received if one of several alternative conditions is fulfilled is without merit. In Canada's view, the complainant's position is at odds with the ordinary meaning of "contingent". If the use of domestic over imported goods were one of several alternative conditions for receiving a subsidy, that subsidy would, by definition, not be "contingent" upon the use of domestic over imported goods, since it could be received without using domestic over imported goods.

(b) Whether the Measure is Contingent "in Fact" upon the Use of Domestic over Imported Goods

54. Canada considers, moreover, that Article 3.1(b) does not extend to measures that are "in fact" contingent upon the use of domestic over imported goods. The Panel's finding on this issue was correct. In Canada's view, the context provided by Article 3.1(a) is determinative. As the words "in law or in fact" are included in Article 3.1(a), the fact that they are not found in Article 3.1(b) indicates that Article 3.1(b) does not apply to contingency "in fact".

55. In any event, Canada argues, Japan and the European Communities have failed to establish that the measure is contingent "in fact" upon the use of domestic over imported goods. As evidence provided by Canada to the Panel demon-

strates, it is not impossible to meet the CVA requirements without using Canadian goods.

G. Third Participants

1. Korea

(a) Article I:1 of the GATT 1994

56. Korea argues that the Canadian measure is inconsistent with Article I:1 of the GATT 1994 because it discriminates with respect to the treatment of like products of different origins. Although the measure does not, on its face, impose conditions relating to the origin of the products at issue, in practice the import duty exemption has not been accorded to like products originating in all WTO Members. In Korea's view, the Panel properly found that the limitation on eligibility for the import duty exemption to certain importers, in combination with the "intra-firm" character of trade in automotive products, results in *de facto* discrimination against like products from certain WTO Members.

(b) Article 3.1(a) of the *SCM Agreement*

(i) Whether the Measure Constitutes a "Subsidy"

57. According to Korea, the measure is a "subsidy" within the meaning of Article 1.1 of the *SCM Agreement*. Customs duties constitute government revenue, and the act of exempting payment of customs duties is an exception to the normal rules. Accordingly, the measure results in government revenue foregone which is "otherwise due", under Article 1.1(a)(1)(ii). Since a benefit is conferred as a result, the measure is a "subsidy" within the meaning of Article 1.1 of the *SCM Agreement*.

(ii) Whether the Measure is "Contingent … in Law … upon Export Performance"

58. Korea contends that, as found by the Panel, the measure is contingent "in law" upon export performance within the meaning of Article 3.1(a) of the *SCM Agreement* as a result of the operation of the ratio requirements. The Panel was correct in its finding that the import duty exemption is contingent upon export performance, regardless of the specific ratio requirements. When the ratio requirements are 100:100 or higher, the import duty exemption cannot be received unless the company exports. When the ratio requirements are less than 100:100, the value of the imports which can be made under the measure is still directly contingent upon the value of exports. This conclusion results from the words of the relevant legal instruments themselves. Therefore, the measure is contingent "in law" upon export performance, under Article 3.1(a) of the *SCM Agreement*.

(c) Article 3.1(b) of the *SCM Agreement*

59. In Korea's view, the Panel erred in its conclusion that the measure does not constitute a subsidy that is contingent "in law" upon the use of domestic over imported goods under the terms of Article 3.1(b) of the *SCM Agreement*, as a result of the operation of the CVA requirements. The CVA requirements are one of several conditions for receiving the import duty exemption. The CVA requirements themselves may be satisfied by the use of Canadian goods, Canadian inputs other than goods, or some combination of the two. Since the use of Canadian goods is one of the means by which to meet the CVA requirements, the measure is contingent "in law" upon the use of domestic over imported goods, within the meaning of Article 3.1(b) of the *SCM Agreement*.

(d) Article I:1 and Article II:1 of the GATS

(i) Article I:1 of the GATS

60. Korea argues that, under Article I of the GATS, the scope of the GATS extends to the Canadian measure. The term "affecting" in Article I:1 of the GATS has a broad reach. In this case, although the measure does not directly govern the supply of services, it nevertheless modifies conditions of competition in the supply of wholesale trade services. It therefore falls within the scope of the GATS.

(ii) Article II:1 of the GATS

61. Korea submits that the Panel was correct in finding that the measure is inconsistent with Article II:1 of the GATS because it does not accord treatment no less favourable to like services and service suppliers of other WTO Members. Through its effect on the conditions of competition, the measure results in *de facto* discrimination based on the origin of the service or service supplier. In fact, the closed category of service suppliers is comprised almost exclusively of service suppliers of the United States and Canada. As a result, some motor vehicle service suppliers of some Members can receive the import duty exemption, while those of other Members cannot, and, consequently, service suppliers of certain Members receive less favourable treatment than service suppliers of other Members.

2. United States

62. In its submission, the United States notes that it "has a strong interest in the systemic implications of the issues presented in this appeal."[43] However, the United States does not make specific arguments on the substantive issues involved. As a result, no arguments made by the United States are summarized in this Section of the Report.

[43] United States' appellant's submission, p.1.

IV. ISSUES RAISED IN THIS APPEAL

63. This appeal raises the following issues:

(a) whether the Panel erred in concluding that Canada acts inconsistently with Article I:1 of the GATT 1994 by according the advantage of duty-free treatment to motor vehicles originating in certain countries, pursuant to the MVTO 1998 and the SROs, which advantage is not accorded immediately and unconditionally to like products originating in the territories of all other WTO Members;

(b) whether the Panel erred in concluding that Canada acts inconsistently with its obligations under Article 3.1(a) of the *SCM Agreement* by granting a subsidy which is contingent in law upon export performance, as a result of the application of the ratio requirements as one of the conditions determining eligibility for the import duty exemption for motor vehicles under the MVTO 1998 and the SROs;

(c) whether the Panel erred in failing to address the European Communities' alternative claim that the import duty exemption, as a result of the application of the CVA requirements as one of the conditions for the import duty exemption, is a subsidy contingent upon export performance within the meaning of Article 3.1(a) of the *SCM Agreement*;

(d) whether the Panel erred in concluding that the European Communities and Japan have failed to demonstrate that Canada acts inconsistently with its obligations under Article 3.1(b) of the *SCM Agreement* by granting a subsidy which is contingent upon the use of domestic over imported goods, as a result of the application of the CVA requirements as one of the conditions determining eligibility for the import duty exemption for motor vehicles under the MVTO 1998 and the SROs; and

(e) whether the Panel erred in its interpretative approach with respect to Article I of the GATS; and in concluding that Canada acts inconsistently with Article II of the GATS by failing to accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country, with respect to the granting of the import duty exemption to a limited number of manufacturers/wholesalers of motor vehicles pursuant to the MVTO 1998 and the SROs.

V. ARTICLE I:1 OF THE GATT 1994

64. Canada appeals the Panel's conclusion that Canada acts inconsistently with Article I:1 of the GATT 1994 by according the advantage of duty-free treatment to motor vehicles originating in certain countries, pursuant to the MVTO 1998 and the SROs, without according that advantage immediately and

unconditionally to like motor vehicles originating in the territories of all other WTO Members.[44]

65. Canada argues that the Panel erred in the way it applied Article I:1 to the measure. In Canada's view, the Panel "simply determined that Article I:1 of the GATT 1994 contemplated *de facto* discrimination and proceeded to consider several factors without providing any legal justification for the scope of its inquiry."[45] These factors included, for Canada, irrelevant empirical data about the market for motor vehicles and the historical aspects of the measure.[46] Instead, Canada considers that the Panel should have based its inquiry on a proper interpretation of the language of Article I:1, and on WTO law and practice.[47]

66. As Canada sees it, Article I:1 does not prohibit the imposition of "origin-neutral terms and conditions on importation that apply to *companies* as opposed to the *products they import*." Canada contends that terms are origin-neutral if they "do not impose limitations with respect to the origin of products that may be imported by those companies."[48] To find otherwise, asserts Canada, would be to hold governments responsible for the sourcing decisions of private commercial entities, and thereby base state-to-state obligations on "ephemeral conditions" outside government control.[49] The level and proportion of trade in motor vehicles from particular foreign sources resulting from the measure, in the view of Canada, is irrelevant for the purposes of Article I:1.[50]

67. The Panel's conclusion that the measure is inconsistent with Article I:1 of the GATT 1994 was based on two main elements. First, the Panel noted that Article I:1 applies to *de facto* discrimination, and can include measures that limit the benefit of the import duty exemption to certain importers only.[51] Second, the Panel recognized, as a finding of fact, the "predominantly, if not exclusively, 'intra-firm' character" of trade in automotive products in Canada.[52] The Panel then reasoned that:

> …in a context of intra-firm trade, the limitation of the availability of the import duty exemption to certain manufacturers, including fully-owned subsidiaries of firms based in a very limited number of third countries, discriminates as to the origin of products which will benefit from the import duty exemption.[53]

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44 Canada's appellant's submission, paras. 1-2.
45 Ibid., para. 20.
46 Ibid., para. 21.
47 Ibid., para. 23.
48 Ibid., para. 27.
49 Ibid., paras. 38 and 51.
50 Ibid., paras. 31-32.
51 Panel Report, paras. 10.38 and 10.40.
52 Ibid., para. 10.42.
53 Ibid., para. 10.45.

The Panel concluded that this discrimination is inconsistent with Article I:1 of the GATT 1994.[54]

68. In support of this finding, the Panel examined the total number and proportions of motor vehicles imported into Canada from various countries, and deduced that these statistics did "not warrant a conclusion that the import duty exemption is accorded on equal terms to like products of different origin."[55] The Panel also examined the historical context of the measure. The Panel found that the import duty exemption:

> …stems from a bilateral agreement between Canada and the United States designed to resolve a long-standing trade dispute between Canada and the United States over trade in automotive products. This agreement was designed *inter alia* to achieve rationalization of production in the North-American market. From the perspective of Canada this involved the granting of import duty exemptions as an encouragement to US owned motor vehicle manufacturers to expand their production operations in Canada. We therefore consider that at the outset the import duty exemption was expected to benefit mainly imports from particular sources.[56]

69. On appeal, the issue before us is whether the import duty exemption accorded by this measure is consistent with Canada's obligations under Article I:1 of the GATT 1994. We are confronted with the daunting task of interpreting certain aspects of the "most-favoured-nation" ("MFN") principle that has long been a cornerstone of the GATT and is one of the pillars of the WTO trading system.

70. In examining the measure in issue, we note that the import duty exemption is afforded by Canada to imports of some, but not all, motor vehicles. We observe, first of all, that the Canadian Customs Tariff provides that a motor vehicle normally enters Canada at an MFN tariff rate of 6.1 per cent.[57] This is also the bound *ad valorem* rate in Canada's WTO Schedule of Concessions.[58] The MVTO 1998 and the SROs modify this rate by providing the import duty exemption for motor vehicles imported by certain manufacturers meeting certain ratio requirements and CVA requirements.[59] The MVTO 1998 accords the import duty exemption in the form of a "reduced rate of customs duty", established in the

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[54] Panel Report, para. 10.50.
[55] Ibid., para. 10.48.
[56] Ibid., para. 10.49.
[57] *Supra*, footnote 19.
[58] Schedule V of Canada, Chapter 87, *Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations*, done at Marrakesh, 15 April 1994.
[59] The operation of the import duty exemption is explained in paras. 7-14 of this Report.

amended Canadian Customs Tariff as "free".[60] The SROs accord the import duty exemption in the form of a full duty "remission".[61]

71. Although the measure on its face imposes no formal restriction on the *origin* of the imported motor vehicle, the Panel found that, in practice, major automotive firms in Canada import only their own make of motor vehicle and those of related companies.[62] Thus, according to the Panel,

> …General Motors in Canada imports only GM motor vehicles and those of its affiliates; Ford in Canada imports only Ford motor vehicles and those of its affiliates; the same is true of Chrysler and of Volvo. These four companies all have qualified as beneficiaries of the import duty exemption. In contrast, other motor vehicle companies in Canada, such as Toyota, Nissan, Honda, Mazda, Subaru, Hyundai, Volkswagen and BMW, all of which also import motor vehicles only from related companies, do not benefit from the import duty exemption.[63]

72. Therefore, the Panel considered that, in practice, a motor vehicle imported into Canada is granted the "advantage" of the import duty exemption only if it originates in one of a small number of countries in which an exporter of motor vehicles is affiliated with a manufacturer/importer in Canada that has been designated as eligible to import motor vehicles duty-free under the MVTO 1998 or under an SRO.

73. Since 1989, no manufacturer not already benefiting from the import duty exemption on motor vehicles has been able to qualify under the MVTO 1998[64] or under an SRO. The list of manufacturers eligible for the import duty exemption was closed by Canada in 1989 in fulfilment of Canada's obligations under the CUSFTA.[65]

74. Thus, in sum, while the Canadian Customs Tariff normally allows a motor vehicle to enter Canada at the MFN duty rate of 6.1 per cent, the same motor vehicle has the "advantage" of entering Canada duty-free when imported by a designated manufacturer under the MVTO 1998 or under the SROs.[66]

75. In determining whether this measure is consistent with Article I:1 of the GATT 1994, we begin our analysis, as always, by examining the words of the treaty. Article I:1 states, in pertinent part:

> With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation…*any* advantage, favour, privilege or immunity granted

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60 MVTO 1998, Parts 1 and 2.
61 See, e.g., CAMI Automotive Inc. Remission Order, SI/89-26, para. 3.
62 Panel Report, para. 10.43.
63 Ibid., para. 10.43.
64 MVTO 1998, Schedule, Part 1, para. 3.
65 *Supra*, footnote 17 and para. 14.
66 Assuming, as above, that that country benefits from Canada's MFN rate.

> by any Member to *any* product originating in or destined for any other country shall be accorded *immediately and unconditionally* to the *like product* originating in or destined for the territories of *all other Members*. (emphasis added)

76. The applicability of certain elements of Article I:1 is not in dispute in this case. First, the parties do not dispute that the import duty exemption is an "advantage, favour, privilege or immunity granted by any Member to any product".[67] Second, it is not disputed that some, but not all, motor vehicles imported from certain Members are accorded the import duty exemption, while some, but not all, like motor vehicles imported from certain other Members are not.[68] Third, the Panel's interpretation that the term "unconditionally" refers to advantages conditioned on the "situation or conduct" of exporting countries has not been appealed.[69]

77. One main issue remains in dispute: has the import duty exemption, accorded by the measure to motor vehicles originating in some countries, in which affiliates of certain designated manufacturers under the measure are present, also been accorded to like motor vehicles from all other Members, in accordance with Article I:1 of the GATT 1994?

78. In approaching this question, we observe first that the words of Article I:1 do not restrict its scope only to cases in which the failure to accord an "advantage" to like products of all other Members appears *on the face* of the measure, or can be demonstrated on the basis of the words of the measure. Neither the words "*de jure*" nor "*de facto*" appear in Article I:1. Nevertheless, we observe that Article I:1 does not cover only "in law", or *de jure*, discrimination. As several GATT panel reports confirmed, Article I:1 covers also "in fact", or *de facto*, discrimination.[70] Like the Panel, we cannot accept Canada's argument that Article I:1 does not apply to measures which, on their face, are "origin-neutral".[71]

79. We note next that Article I:1 requires that "*any advantage*, favour, privilege or immunity granted by any Member to *any product* originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of *all other Members*." (emphasis added) The words of Article I:1 refer not to *some* advantages

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[67] Panel Report, para. 10.16.

[68] Ibid., paras. 10.32-10.33 and 10.36.

[69] Ibid., para. 10.23.

[70] We note, though, that the measures examined in those reports differed from the measure in this case. Two of those reports dealt with "like" product issues: panel report, *Spain - Tariff Treatment of Unroasted Coffee*, L/5135, adopted 11 June 1981, BISD 28S/102; panel report, *Canada/Japan - Tariff on Imports of Spruce, Pine, Fir (SPF) Dimension Lumber*, L/6470, adopted 19 July 1989, BISD 36S/167. In this case, as we have noted, there is no dispute that the motor vehicles subject to the import duty exemption are "like" products. Furthermore, two other reports dealt with measures which, on their face, discriminated on a strict "origin" basis, so that, at any given time, either *every* product, or *no* product, of a particular origin was accorded an advantage. See panel report, *Belgian Family Allowances*, G/32, adopted 7 November 1952, BISD 1S/59; panel report, *European Economic Community - Imports of Beef from Canada*, L/5099, adopted 10 March 1981, BISD 28S/92. In this case, motor vehicles imported into Canada are not disadvantaged in that same sense.

[71] Panel Report, para. 10.40.

granted "with respect to" the subjects that fall within the defined scope of the Article, but to "*any advantage*"; not to *some* products, but to "*any product* "; and not to like products from *some* other Members, but to like products originating in or destined for "*all other*" Members.

80. We note also the Panel's conclusion that, in practice, a motor vehicle imported into Canada is granted the "advantage" of the import duty exemption only if it originates in one of a small number of countries in which an exporter of motor vehicles is affiliated with a manufacturer/importer in Canada that has been designated as eligible to import motor vehicles duty-free under the MVTO 1998 or under an SRO.

81. Thus, from both the text of the measure and the Panel's conclusions about the practical operation of the measure, it is apparent to us that "[w]ith respect to customs duties…imposed on or in connection with importation…," Canada has granted an "advantage" to some products from some Members that Canada has not "accorded immediately and unconditionally" to "like" products "originating in or destined for the territories of *all other Members*." (emphasis added) And this, we conclude, is not consistent with Canada's obligations under Article I:1 of the GATT 1994.

82. The context of Article I:1 within the GATT 1994 supports this conclusion. Apart from Article I:1, several "MFN-type" clauses dealing with varied matters are contained in the GATT 1994.[72] The very existence of these other clauses demonstrates the pervasive character of the MFN principle of non-discrimination.

83. The drafters also wrote various exceptions to the MFN principle into the GATT 1947 which remain in the GATT 1994.[73] Canada invoked one such exception before the Panel, relating to customs unions and free trade areas under Article XXIV. This justification was rejected by the Panel, and the Panel's findings on Article XXIV were not appealed by Canada. Canada has invoked no other provision of the GATT 1994, or of any other covered agreement, that would justify the inconsistency of the import duty exemption with Article I:1 of the GATT 1994.

84. The object and purpose of Article I:1 supports our interpretation. That object and purpose is to prohibit discrimination among like products originating in or destined for different countries. The prohibition of discrimination in Article I:1 also serves as an incentive for concessions, negotiated reciprocally, to be extended to all other Members on an MFN basis.

85. The measure maintained by Canada accords the import duty exemption to certain motor vehicles entering Canada from certain countries. These privileged motor vehicles are imported by a limited number of designated manufacturers

[72] These relate to such matters as internal mixing requirements (Article III:7); cinema films (Article IV(b)); transit of goods (Article V:2, 5, 6); marks of origin (Article IX:1); quantitative restrictions (Article XIII:1); measures to assist economic development (Article XVIII:20); and measures for goods in short supply (Article XX(j)).

[73] Such as in Articles XX (general exceptions), XXI (security exceptions) and XXIV (customs unions and free trade areas).

who are required to meet certain performance conditions. In practice, this measure does not accord the same import duty exemption immediately and unconditionally to like motor vehicles of *all* other Members, as required under Article I:1 of the GATT 1994. The advantage of the import duty exemption is accorded to some motor vehicles originating in certain countries without being accorded to like motor vehicles from *all* other Members. Accordingly, we find that this measure is not consistent with Canada's obligations under Article I:1 of the GATT 1994.

86. We, therefore, uphold the Panel's conclusion that Canada acts inconsistently with Article I:1 of the GATT 1994 by according the advantage of the import duty exemption to motor vehicles originating in certain countries, pursuant to the MVTO 1998 and the SROs, which advantage is not accorded immediately and unconditionally to like products originating in the territories of all other WTO Members.

VI. ARTICLE 3.1(A) OF THE *SCM AGREEMENT*

A. Whether the Measure Constitutes a "Subsidy"

87. Canada appeals the Panel's finding that the measure is a "subsidy" within the meaning of Article 1.1 of the *SCM Agreement*.[74] For Canada, the measure does not, in the language of Article 1.1, forego "government revenue that is otherwise due".[75] Canada argues that the import duty exemption at issue here cannot be equated mechanically with a tax exemption, such as the one at issue in *United States - Tax Treatment for "Foreign Sales Corporations"* ("*United States - FSC*").[76] For Canada, the import duty exemption should be considered a "subsidy" only if it provides an exemption from duties *in excess* of those that would have "accrued".[77] Canada maintains, as well, that most motor vehicles benefiting from the import duty exemption could have been imported into Canada duty-free under the NAFTA.[78]

88. The Panel found that the measure results, within the terms of Article 1.1 of the *SCM Agreement*, in "government revenue" foregone that is "otherwise due", and therefore constitutes a "financial contribution".[79] For the Panel, Canada's argument that "if an import duty exemption were necessarily treated as revenue foregone, a subsidy would exist every time generalised preferences or duty drawbacks were granted by a WTO Member" [80] is inapposite. The Panel stated that "these examples advanced by Canada involve factual and legal con-

[74] Canada's appellant's submission, para. 57.
[75] Ibid., para. 60.
[76] Appellate Body Report, WT/DS108/AB/R, adopted 20 March 2000; DSR 2000:III, 1619, Canada's appellant's submission, para. 69.
[77] Canada's appellant's submission, para. 72.
[78] Ibid., para. 73.
[79] Panel Report, para. 10.163.
[80] Ibid., para. 10.162.

siderations distinct from those in the case at hand".[81] In addition, the Panel found that a "benefit" is conferred by this "financial contribution".[82] The Panel therefore concluded that there is a "subsidy" within the meaning of Article 1.1.

89. In considering this conclusion on appeal, we look first at the wording of Article 1.1 of the *SCM Agreement*, which states, *inter alia*, that a "subsidy" exists if "there is a financial contribution by a government… and a benefit is thereby conferred". A "financial contribution" is deemed to exist, *inter alia*, where "government revenue that is *otherwise due* is foregone or not collected".[83] (emphasis added)

90. It is not in dispute that import duties are "government revenue", and that the import duty exemption afforded by this measure confers a "benefit" upon its recipients under Article 1.1(b) of the *SCM Agreement*. What is in dispute is whether "government revenue that is *otherwise due is foregone*" in the sense of Article 1.1(a)(1)(ii) of the *SCM Agreement*. In *United States - FSC*, we said the following about the United States tax measure at issue there:

> In our view, the "*foregoing*" of revenue "*otherwise* due" implies that less revenue has been raised by the government than would have been raised in a different situation, or, that is, "otherwise". Moreover, the word "foregone" suggests that the government has given up an entitlement to raise revenue that it could "otherwise" have raised. This cannot, however, be an entitlement in the abstract, because governments, in theory, could tax *all* revenues. There must, therefore, be some defined, normative benchmark against which a comparison can be made between the revenue actually raised and the revenue that would have been raised "otherwise". We, therefore, agree with the Panel that the term "otherwise due" implies some kind of comparison between the revenues due under the contested measure and revenues that would be due in some other situation. We also agree with the Panel that the basis of comparison must be the tax rules applied by the Member in question. … What is "otherwise due", therefore, depends on the rules of taxation that each Member, by its own choice, establishes for itself.[84]

91. The principles stated in that case also apply here. We note, once more, that Canada has established a normal MFN duty rate for imports of motor vehicles of 6.1 per cent.[85] Absent the import duty exemption, this duty would be paid on imports of motor vehicles. Thus, through the measure in dispute, the Government of Canada has, in the words of *United States - FSC*, "given up an entitle-

[81] Panel Report, para. 10.162.
[82] Ibid., para. 10.165.
[83] Article 1.1(a)(1)(ii) of the *SCM Agreement*.
[84] *Supra*, footnote 76, para. 90.
[85] *Supra*, footnote 19.

ment to raise revenue that it could 'otherwise' have raised."[86] More specifically, through the import duty exemption, Canada has ignored the "defined, normative benchmark" that it established for itself for import duties on motor vehicles under its normal MFN rate and, in so doing, has foregone "government revenue that is otherwise due".

92. Canada argues that the measure is "analogous" to the situation described in footnote 1 to the *SCM Agreement*, which provides that "the exemption of an exported product from duties or taxes borne by the like product when destined for domestic consumption, or the remission of such duties or taxes in amounts not in excess of those which have accrued, shall not be deemed to be a subsidy." We do not share Canada's view. Footnote 1 to the *SCM Agreement* deals with duty and tax exemptions or remissions for *exported* products. The measure at issue applies, in contrast, to *imports* of motor vehicles which are sold for consumption in Canada. For this reason, we do not consider that footnote 1 bears upon the import duty exemption at issue in this case.

93. In our view, it is also not relevant that motor vehicles benefiting from the import duty exemption may enter Canada duty-free if imported under the provisions of the NAFTA. Duty-free treatment under the NAFTA is not at issue in this case. The measure at issue in this case is the import duty exemption set out in the MVTO 1998 and the SROs.

94. For these reasons, we uphold the Panel's finding that "government revenue that is otherwise due is foregone" and that the measure constitutes a "subsidy" under Article 1.1 of the *SCM Agreement*.[87]

B. Whether the Measure is "Contingent … in Law … upon Export Performance"

95. Canada appeals the Panel's finding that the measure is a subsidy which is "contingent … in law … upon export performance" within the meaning of Article 3.1(a) of the *SCM Agreement*. Canada argues that the Panel erred in law by misinterpreting the definition of "contingent", and alleges that the Panel did not "even attempt to demonstrate contingency 'on the basis of the words of the relevant legislation…'; instead, it resorted to hypothetical 'facts'."[88] Thus, Canada maintains that the Panel erroneously found the measure contingent "in law" upon export performance because it conducted a "hypothetical" analysis of certain factual elements.[89] Canada submits, furthermore, that the facts relating to the measure do not demonstrate that it is *de facto* contingent upon export performance.[90]

96. The Panel concluded that the subsidy provided by the measure is "contingent … in law … upon export performance" within the meaning of Article 3.1(a)

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86 *Supra*, footnote 76, para. 90.
87 Panel Report, para. 10.170.
88 Canada's appellant's submission, para. 77.
89 Ibid., para. 78.
90 Ibid., para. 80.

of the *SCM Agreement*.[91] In its analysis, the Panel examined the ratio requirements, but not the CVA requirements[92], of the measure under the MVTO 1998 and the SROs. The Panel found that "the MVTO 1998 and the SROs demonstrate, on their face, that the import duty exemption is contingent upon export performance…".[93]

97. Article 3.1 of the *SCM Agreement* provides, in pertinent part:

> Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited:
>
> (a) subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I;
>
> …
>
> (footnotes omitted)

98. In *Canada - Measures Affecting the Export of Civilian Aircraft* ("*Canada - Aircraft* "), we noted that the key word in Article 3.1(a) is "contingent":

> …the ordinary connotation of "contingent" is "conditional" or "dependent for its existence on something else". This common understanding of the word "contingent" is borne out by the text of Article 3.1(a), which makes an explicit link between "contingency" and "conditionality" in stating that export contingency can be the sole or "one of several other *conditions*".[94] (footnote omitted)

99. Although in *Canada - Aircraft* we were dealing with a subsidy that was contingent "in fact" upon export performance, we stated in that case that "the legal standard expressed by the word 'contingent' is the same for both *de jure* or *de facto* contingency."[95] We stated, furthermore, that:

> There is a difference, however, in what evidence may be employed to prove that a subsidy is export contingent. <u>*De jure* export contingency is demonstrated on the basis of the words of the relevant legislation, regulation or other legal instrument</u>. Proving *de facto* export contingency is a much more difficult task. There is no single legal document which will demonstrate, on its face, that a subsidy is "contingent…in fact…upon export performance". Instead, the existence of this relationship of contingency, between the sub-

[91] Panel Report, para. 10.201.

[92] The Panel's failure to examine the European Communities' claim relating to the CVA requirements under Article 3.1(a) of the *SCM Agreement* is dealt with in Section VII of this Report.

[93] Panel Report, para. 10.192.

[94] Appellate Body Report, WT/DS70/AB/R, adopted 20 August 1999, DSR 1999:III, 1377, para. 166.

[95] Appellate Body Report, WT/DS70/AB/R, adopted 20 August 1999, DSR 1999:III, 1377, para. 167.

> sidy and export performance, must be *inferred* from the total configuration of the facts constituting and surrounding the granting of the subsidy, none of which on its own is likely to be decisive in any given case.[96]
>
> (emphasis in italics in the original; emphasis in underlining added)

100. We start with what we have held previously. In our view, a subsidy is contingent "in law" upon export performance when the existence of that condition can be demonstrated on the basis of the very words of the relevant legislation, regulation or other legal instrument constituting the measure. The simplest, and hence, perhaps, the uncommon, case is one in which the condition of exportation is set out expressly, in so many words, on the face of the law, regulation or other legal instrument. We believe, however, that a subsidy is also properly held to be *de jure* export contingent where the condition to export is clearly, though implicitly, in the instrument comprising the measure. Thus, for a subsidy to be *de jure* export contingent, the underlying legal instrument does not always have to provide *expressis verbis* that the subsidy is available only upon fulfillment of the condition of export performance. Such conditionality can also be derived by necessary implication from the words actually used in the measure.

101. In this case, the key legal instrument setting out the ratio requirements is the MVTO 1998. The Panel found that, for the four MVTO automobile manufacturer beneficiaries, the MVTO 1998 is the *only* legal instrument setting out the ratio requirements.[97] For the manufacturers that are beneficiaries under the SROs, each SRO specifies a precise ratio requirement for the company for which it is issued.[98]

102. The Panel found, as a matter of fact, that:

> …the ratio requirements applicable to the MVTO 1998 beneficiaries are, "as a general rule", 95:100 for automobiles, at least 75:100 for SCVs and at least 75:100 for buses. With respect, specifically, to the four automobile manufacturer beneficiaries under the MVTO 1998, Canada has stated, in response to a question from the Panel, that the amounts of the ratio requirements are confidential. Canada adds that they range from the low-80s:100 to the high-90s:100, and the average of the four amounts is approximately 95:100. We further note that the SROs issued prior to 1997 set the minimum ratio requirement at 75:100. Regarding the SROs issued since 1997, almost all such

[96] *Supra*, footnote 94, para. 167.
[97] Panel Report, para. 10.193.
[98] Ibid., para. 10.182.

> SROs have the ratio requirement set at 100:100.[99] (footnotes omitted)

103. As the MVTO 1998 is the key legal instrument setting out the ratio requirements, compliance with which enables a manufacturer to qualify for the import duty exemption, it is important to quote the relevant aspects of the definition of "manufacturer" in that regulation:

> "[M]anufacturer" means a manufacturer of a class of vehicles who
>
> …
>
> (b) produced vehicles of a class in Canada in the 12-month period ending on July 31 in which the importation is made where
>
> > (i) the ratio of the net sales value of the vehicles produced to the net sales value of all vehicles of that class sold for consumption in Canada by the manufacturer in that period is equal to or higher than the ratio of the net sales value of all vehicles of that class produced in Canada by the manufacturer in the base year to the net sales value of all vehicles of that class sold for consumption in Canada by the manufacturer in the base year, and is not in any case lower than 75 to 100…[100]

104. We agree with the Panel that "[i]n cases where the production-to-sales ratio is 100:100, the only way to import any motor vehicles duty-free is to export, and the amount of import duty exemption allowed is directly dependent upon the amount of exports achieved." [101] Like the Panel, we fail to see how a manufacturer with a production-to-sales ratio of 100:100 could obtain access to the import duty exemption - and still maintain its required production-to-sales ratio - without exporting. A manufacturer producing motor vehicles in Canada with a sales value of 100 that does not export must sell all those motor vehicles in Canada. That manufacturer's production-to-sales ratio becomes 100:100, but without the benefit of importing duty-free one single motor vehicle. Only if that manufacturer exports motor vehicles produced in Canada does it become entitled to import motor vehicles free of duty. The value of motor vehicles which can be imported duty-free is strictly limited to the value of motor vehicles exported. In our view, as the import duty exemption is simply not available to a manufacturer unless it exports motor vehicles, the import duty exemption is clearly conditional, or dependent upon, exportation and, therefore, is contrary to Article 3.1(a) of the *SCM Agreement*.

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[99] Ibid. We note that the Panel referred to "1997" rather than "1977" in para. 10.182 of the Panel Report. We believe this reference is simply a clerical error, as confirmed by the Panel's reference to "1977" in para. 2.34 of its Report.

[100] MVTO 1998, Schedule, Part 1, para. 1(1), definition of "manufacturer".

[101] Panel Report, para. 10.184.

105. Where the ratio requirements are set at less than 100:100 (for example, we know that the four MVTO automobile manufacturer beneficiaries have, on average, ratio requirements of approximately 95:100)[102], the relationship between exports and the ability to import duty-free is less straightforward. With a ratio requirement of 95:100, a manufacturer producing motor vehicles in Canada with a sales value of 95 that does not export is nevertheless entitled to import, duty-free, additional motor vehicles with a sales value of 5. If that manufacturer doubles its Canadian production to 190, then the amount of the duty-free "allowance" also doubles, to 10; that is, the "allowance" increases in direct proportion to the increase in production. The Panel considered that, up to this amount, the import duty exemption is not contingent upon export performance.[103] However, should a manufacturer wish to import on a duty-free basis any motor vehicles above its "allowance", that manufacturer must export motor vehicles. As in the case of a 100:100 ratio requirement, for a manufacturer with a ratio requirement less than 100:100, for any amount above this duty-free "allowance", the value of vehicles which can be imported duty-free is strictly limited, and tied to, the value of vehicles exported. The Panel found that for the amount exceeding the duty-free "allowance" there is, therefore, a clear relationship of contingency between the import duty exemption and export performance. [104]

106. We share the Panel's view. Regardless of the actual ratio specified for a particular manufacturer, the MVTO 1998 and the SROs operate, as a matter of law, in such a manner that the more motor vehicles a manufacturer exports, the more motor vehicles that manufacturer is entitled to import duty-free.

107. Although we are not examining whether the subsidy in this case is contingent "in fact" upon export performance, we note that footnote 4 to Article 3.1(a) uses the words "tied to" as a synonym for "contingent" or "conditional". As the legal standard is the same for *de facto* and *de jure* export contingency[105], we believe that a "tie", amounting to the relationship of contingency, between the granting of the subsidy and actual or anticipated exportation meets the legal standard of "contingent" in Article 3.1(a) of the *SCM Agreement*.

108. Even where the ratio requirement for a particular manufacturer is set at less than 100:100, in our view, there is contingency "in law" upon export performance because, as a result of the operation of the MVTO 1998 and the SROs themselves, the granting of, or the entitlement to, the import duty exemption is tied to the exportation of motor vehicles by the manufacturer beneficiaries. By the very operation of the measure, the more motor vehicles that a manufacturer exports, the more motor vehicles it can import duty-free. In other words, a clear relationship of dependency or conditionality exists between the granting of the import duty exemption and the exportation of motor vehicles by manufacturer beneficiaries. We find, therefore, that, even when the ratio requirements are less than 100:100, the measure is "contingent…in law…upon export performance".

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[102] Panel Report, para. 10.182.
[103] Ibid., para. 10.188.
[104] Ibid., para. 10.191.
[105] Appellate Body Report, *Canada - Aircraft*, *supra*, footnote 94, para. 167.

109. For these reasons, we uphold the Panel's conclusion that the measure is a "subsidy" as that term is used in Article 1 of the *SCM Agreement* which is "contingent…in law…upon export performance" within the meaning of Article 3.1(a) of the same Agreement. Accordingly, we also uphold the Panel's finding that Canada acts inconsistently with its obligations under Article 3.1(a) of the *SCM Agreement*.[106]

VII. ARTICLE 3.1(A) OF THE *SCM AGREEMENT* - EUROPEAN COMMUNITIES' CLAIM REGARDING CVA REQUIREMENTS

110. The European Communities argues that the Panel failed to examine the claim of the European Communities that the CVA requirements constitute a subsidy contingent upon export performance in contravention of Article 3.1(a) of the *SCM Agreement*, and that this failure constitutes a legal error.[107] Although the European Communities does not specify the precise legal error it is alleging, and does not refer to any provision in the *WTO Agreement* that has been infringed, it would appear that the European Communities is alleging that the Panel did not act in accordance with Article 11 of the DSU, in particular, in applying the principle of judicial economy.

111. An examination of the Panel Report reveals that the Panel made no mention in its findings of the European Communities' *alternative* claim that the CVA requirements condition of the measure is inconsistent with Article 3.1(a) of the *SCM Agreement*.[108] To all appearances, the Panel simply overlooked this *alternative* claim. Instead, the Panel dealt with several related claims of the European Communities. The Panel found that the CVA requirements are inconsistent with Article III:4 of the GATT 1994[109] and Article XVII of the GATS[110], but are consistent with Article 3.1(b) of the *SCM Agreement*.[111] The Panel also found that the measure is a prohibited export subsidy under Article 3.1(a) of the *SCM Agreement* because of the condition of the ratio requirements.[112]

112. In assessing this allegation of legal error made by the European Communities, we refer to the obligations of panels set out in very general terms in Article 11 of the DSU. This provision reads, in relevant part:

> …a panel should make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements, and *make such other findings as will assist the DSB* in making the recommendations or in

[106] Panel Report, para. 10.201.
[107] European Communities' appellant's submission, paras. 62-64.
[108] Ibid., para. 64.
[109] Panel Report, para. 10.90.
[110] Ibid., para. 10.308.
[111] Ibid., paras. 10.216 and 10.222.
[112] Ibid., para. 10.201.

> giving the rulings provided for in the covered agreements. (emphasis added)

113. The standard terms of reference of a panel, set out in Article 7.1 of the DSU, speak in very similar terms. A panel should make "such findings as will assist the DSB" in making recommendations or rulings. Under Article 7.2 of the DSU, a panel "shall address the relevant provisions in any covered agreement or agreements cited by the parties to the dispute."

114. In discharging its functions under Articles 7 and 11 of the DSU, a panel is not, however, required to examine *all* legal claims made before it. A panel may exercise judicial economy. In *United States - Measure Affecting Imports of Woven Wool Shirts and Blouses from India*, we said:

> Nothing in [Article 11 of the DSU] or in previous GATT practice *requires* a panel to examine *all* legal claims made by the complaining party. Previous GATT 1947 and WTO panels have frequently addressed only those issues that such panels considered necessary for the resolution of the matter between the parties, and have declined to decide other issues. Thus, if a panel found that a measure was inconsistent with a particular provision of the GATT 1947, it generally did not go on to examine whether the measure was also inconsistent with other GATT provisions that a complaining party may have argued were violated.[113]

115. We refined this notion in *Australia - Measures Affecting the Importation of Salmon* ("*Australia - Salmon*"), where we said:

> The principle of judicial economy has to be applied keeping in mind the aim of the dispute settlement system. This aim is to resolve the matter at issue and "to secure a positive solution to a dispute". To provide only a partial resolution of the matter at issue would be false judicial economy. *A panel has to address those claims on which a finding is necessary in order to enable the DSB to make sufficiently precise recommendations and rulings so as to allow for prompt compliance by a Member* with those recommendations and rulings "in order *to ensure effective resolution of disputes* to the benefit of all Members."[114] (emphasis added; footnote omitted)

116. In our view, it was not necessary for the Panel to make a determination on the European Communities' *alternative* claim relating to the CVA requirements under Article 3.1(a) of the *SCM Agreement* in order "to secure a positive solution" to this dispute. The Panel had already found that the CVA requirements violated both Article III:4 of the GATT 1994 and Article XVII of the GATS.

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[113] Appellate Body Report, WT/DS33/AB/R and Corr. 1, adopted 23 May 1997, DSR 1997:Ibid., 323, at 339.

[114] Ibid., WT/DS18/AB/R, adopted 6 November 1998, DSR 1998:VIII, 3327, para. 223.

Having made these findings, the Panel, in our view, exercising the discretion implicit in the principle of judicial economy, could properly decide not to examine the *alternative* claim of the European Communities that the CVA requirements are inconsistent with Article 3.1(a) of the *SCM Agreement.*

117. We are bound to add that, for purposes of transparency and fairness to the parties, a panel should, however, in all cases, address expressly those claims which it declines to examine and rule upon for reasons of judicial economy. Silence does not suffice for these purposes.

VIII. ARTICLE 3.1(b) OF THE *SCM AGREEMENT*

118. The European Communities and Japan appeal the Panel's finding that they failed to demonstrate that the import duty exemption is a subsidy which is "contingent…upon the use of domestic over imported goods" under Article 3.1(b) of the *SCM Agreement*. They maintain that the Panel erred in concluding that the measure is not contingent "in law" upon the use of domestic over imported goods.[115] In the alternative, the European Communities and Japan claim that the Panel erred in concluding that Article 3.1(b) does not extend to contingency "in fact", and they assert that the import duty exemption is contingent "in fact" upon the use of domestic over imported goods.[116] We address each of these issues in turn.

A. Whether the Measure is Contingent "in Law" Upon the Use of Domestic over Imported Goods

119. In appealing the Panel's conclusion regarding contingency "in law", the European Communities argues that Article 3.1(b) of the *SCM Agreement* prohibits subsidies contingent upon a condition that "gives preference to" the use of domestic over imported goods.[117] On the other hand, Japan submits that Article 3.1(b) prohibits subsidies where the use of domestic over imported goods "would lead to" the granting or maintaining of the subsidy.[118] In their view, the Panel's interpretation is incompatible with the object and purpose of Article 3.1(b), and would allow circumvention of this provision.[119] Furthermore, the European Communities and Japan argue that, applying the test used by the Panel, the CVA requirements, in certain circumstances, do require the "actual use of domestic goods"[120] as a matter of law.[121] Finally, according to the European Communities and Japan, the use of domestic over imported goods as a result of the CVA requirements is an "alternative" condition "in law" for receiving the import duty

[115] European Communities' appellant's submission, para. 5; Japan's appellant's submission, para. 2.
[116] Ibid., para. 5; Japan's appellant's submission, para. 2.
[117] Ibid., para. 23.
[118] Japan's appellant's submission, para. 7.
[119] European Communities' appellant's submission, para. 25; Japan's appellant's submission, paras. 8 and 14.
[120] Ibid., para. 28.
[121] See Japan's appellant's submission, para. 11.

exemption, and is, therefore, inconsistent with Article 3.1(b) of the *SCM Agreement*.[122]

120. In examining the CVA requirements under Article 3.1(b), the Panel stated:

> As we noted in the section of our report relating to claims under Article 3.1(a) of the *SCM Agreement*, the word "contingent" has been defined, *inter alia*, as "conditional, dependent". It is in light of this ordinary meaning of the word "contingent" that we must examine whether, under the CVA requirements outlined above, access to the import duty exemption is conditional or dependent upon the use of domestic over imported goods.[123]

121. The Panel found that:

> …while under the MVTO 1998 and SROs access to the import duty exemption is contingent upon satisfying certain CVA requirements, a value-added requirement is in no sense synonymous with a condition to use domestic over imported goods. In this regard, we recall that the definition of "CVA" in the MVTO 1998 includes, in addition to parts and materials of Canadian origin, such other elements as direct labour costs, manufacturing overheads, general and administrative expenses and depreciation. Thus, and depending upon the factual circumstances, a manufacturer might well be willing and able to satisfy a CVA requirement without using any domestic goods whatsoever. *Under these circumstances, it would be difficult for us to conclude that access to the import duty exemption is contingent, i.e. conditional or dependent, in law on the use of domestic over imported goods within the meaning of the SCM Agreement*.[124] (emphasis added)

122. Article 3.1(b) provides as follows:

> Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited:
>
> …
>
> (b) subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods.

[122] European Communities' appellant's submission, paras. 43-50; Japan's appellant's submission, paras. 9 and 17.
[123] Panel Report, para. 10.213.
[124] Ibid., para. 10.216.

As we have already found that the import duty exemption constitutes a "subsidy" within the meaning of Article 1 of the *SCM Agreement*, we turn to whether this subsidy is contingent "in law" upon the use of domestic over imported goods.

123. In our discussion of Article 3.1(a) in Section VI of this Report, we recalled that in *Canada - Aircraft* we stated that "the ordinary connotation of 'contingent' is 'conditional' or 'dependent for its existence on something else'." [125] Thus, a subsidy is prohibited under Article 3.1(a) if it is "conditional" upon export performance, that is, if it is "dependent for its existence on" export performance. In addition, in *Canada - Aircraft*, we stated that contingency "in law" is demonstrated "on the basis of the *words* of the relevant legislation, regulation or other legal instrument." [126] (emphasis added) As we have already explained, such conditionality can be derived by necessary implication from the words actually used in the measure.[127] We believe that this legal standard applies not only to "contingency" under Article 3.1(a), but also to "contingency" under Article 3.1(b) of the *SCM Agreement*.

124. As we are considering a claim of "in law" contingency under Article 3.1(b), it is important to quote the definition of "Canadian value added" set out in the key legal instrument, the MVTO 1998:

> "Canadian value added" means
>
> (a) in relation to a class of vehicles produced in Canada in any 12-month period ending on July 31, *the aggregate of the following costs* to the manufacturer of producing all vehicles of that class that are produced in Canada by the manufacturer in that period and the following depreciation and capital cost allowances for that period, *namely*,
>
> (i) *the cost of parts produced in Canada, and the cost of materials to the extent that they are of Canadian origin*, that are incorporated in vehicles in the factory of the manufacturer in Canada, but not including parts produced in Canada, or materials to the extent that they are of Canadian origin, that have been exported from Canada and subsequently imported into Canada as parts or materials,
>
> (ii) transportation costs, including insurance charges,…
>
> (iii) notwithstanding subparagraph (i), the cost of the iron, steel and aluminum content of parts produced outside Canada for incorporation in the vehicles, if the iron, steel or aluminum was poured in Canada,…
>
> (iv) the part of the following costs that is reasonably attributable to the production of the vehicles, namely,
>
> (A) wages paid for direct production labour in Canada,

[125] *Supra*, footnote 94, para. 166.
[126] *Supra*, footnote 94, para. 167.
[127] *Supra*, para. 100.

> (B) wages paid for indirect production and non-production labour in Canada,
>
> (C) the cost of materials used in the production operation but not incorporated in the final product,
>
> (D) the cost of heating, lighting, power and water,
>
> (E) worker's compensation, employment insurance and group insurance premiums, pension contributions and similar expenses incurred in respect of labour referred to in clauses (A) and (B),
>
> (F) taxes on land and buildings in Canada,
>
> (G) fire and other insurance premiums,…
>
> (H) rent for factory premises paid to the beneficial owner in Canada,
>
> (I) the cost of maintenance and repair work executed in Canada on buildings, machinery and equipment used for production purposes,
>
> (J) the cost of tools, dies, jigs, fixtures and other similar equipment of a non-permanent nature that have been manufactured in Canada,
>
> (K) the cost of engineering services, experimental work and product development work executed in Canada, and
>
> (L) miscellaneous factory expenses,
>
> (v) administrative and general expenses incurred in Canada that are reasonably attributable to the production of the vehicles,
>
> (vi) depreciation…, *and*
>
> (vii) a capital cost allowance…[128] (emphasis added)

This definition also applies to the SROs.

125. The import duty exemption at issue in this appeal is contingent on the satisfaction of three requirements: (1) manufacturing presence in Canada, (2) the ratio requirements, and (3) the CVA requirements. The Panel found that each of these requirements was a "condition" for receiving the import duty exemption.[129] Under the measure, a manufacturer applying for the import duty exemption in a particular period is required to disclose to the Government of Canada the *aggregate* of the costs, listed in the definition of "Canadian value added" in the MVTO 1998, of producing vehicles in Canada, so as to demonstrate that the manufacturer has satisfied the CVA requirements. One of these costs - indeed, the first one listed - is Canadian parts and materials incorporated in motor vehicles in the factory of the manufacturer in Canada, that is, "domestic goods".

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[128] MVTO 1998, Schedule, Part 1, para. 1(1), definition of "Canadian value added".
[129] Panel Report, para. 10.4.

126. The precise issue under Article 3.1(b) is whether the *use* of domestic over imported goods is a "condition" for satisfying the CVA requirements, and, therefore, for receiving the import duty exemption.

127. In examining this issue, the Panel first set out the CVA requirements, as contained in three separate legal instruments: the MVTO 1998, the SROs, and the Letters of Undertaking.[130] With respect to the MVTO 1998, the Panel did not make any specific findings regarding the actual percentages of CVA required for individual manufacturer beneficiaries. The Panel simply noted that "there are the CVA requirements under the MVTO 1998 itself ".[131] For the SROs, the Panel discussed "typical" levels of CVA required for companies operating under SROs issued before 1984 and those issued from 1984 onwards. For one manufacturer, CAMI Automotive Inc. ("CAMI"), the Panel stated that it "must meet a requirement that the total CVA of its vehicles and original equipment manufacturing parts produced in Canada in a given year must be at least 60 per cent of the cost of sales of vehicles sold in Canada in the same year." [132] With regard to the Letters of Undertaking signed by General Motors, Ford, Chrysler and American Motors, the Panel noted that these Letters require an *increase* in the amount of CVA by an amount equal to 60 per cent of the growth in their market for automobiles sold for consumption in Canada and by an amount equal to 50 per cent of the growth in their market for commercial vehicles sold for consumption in Canada, and include a requirement to achieve a stipulated increase in the annual CVA by the end of model year 1968. However, the Panel did *not* determine what the *actual* amount of CVA required is under those Letters.[133] The Panel added, in a footnote, that "[c]ompliance with [the Letters] is not explicitly a factor in determining the eligibility for the import duty exemption." [134] Apparently, the Panel found that the CVA requirements in the Letters are not "conditions" additional to those in the MVTO 1998 for the MVTO manufacturers.

128. The Panel then examined whether the import duty exemption is contingent "in law" upon the use of domestic over imported goods. In its examination, however, the Panel did not conduct an analysis of how the CVA requirements under the MVTO 1998 and the SROs actually work. The Panel began its legal analysis by stating that "a value-added requirement is in no sense synonymous with a condition to use domestic over imported goods." [135] The Panel apparently reached this conclusion without any inquiry into the specific CVA requirements for specific manufacturer beneficiaries. Although the Panel did explain what *types* of costs could be used to satisfy the CVA requirements, the Panel did not, for any MVTO manufacturer or for particular SRO manufacturers (with the exception of CAMI), make any findings as to the *actual level* of CVA required. The Panel's statement that "value-added requirements" are "not synonymous" with a condition to use domestic over imported goods seems to have been based on

[130] Panel Report, paras. 10.203-10.206.
[131] Ibid., para. 10.204.
[132] Ibid., para. 10.205.
[133] Ibid., Panel Report, para. 10.206.
[134] Ibid., footnote 896.
[135] Ibid., para. 10.216.

"value-added requirements" considered *in the abstract* as opposed to the actual CVA requirements for the MVTO and SRO manufacturer beneficiaries.

129. The Panel then recalled the following:

> …we recall that the definition of "CVA" in the MVTO 1998 includes, in addition to parts and materials of Canadian origin, such other elements as direct labour costs, manufacturing overheads, general and administrative expenses and depreciation. *Thus, and depending upon the factual circumstances, a manufacturer might well be willing and able to satisfy a CVA requirement without using any domestic goods whatsoever*.[136] (emphasis added)

Once again, the Panel reached its conclusion here without examining the specific CVA requirements in the MVTO 1998 and the SROs. The Panel simply speculated that "depending upon the factual circumstances", a manufacturer "*might well be* willing and *able* to satisfy a CVA requirement *without using any domestic goods whatsoever*". (emphasis added) The Panel did not, however, scrutinize the actual CVA requirements for MVTO and SRO manufacturers to see whether they could indeed be satisfied without using domestic goods.

130. The Panel's reasoning implies that under no circumstances could *any* value-added requirement result in a finding of contingency "in law" upon the use of domestic over imported goods. We do not agree. We noted that the definition of "Canadian value added" in the MVTO 1998 *requires* a manufacturer to report to the Government of Canada the *aggregate* of certain listed costs of its production of motor vehicles, and that the first such cost item specified is the cost of Canadian parts and materials *used* in the production of motor vehicles in its factory in Canada.[137] It seems to us that whether or not a particular manufacturer is able to satisfy its specific CVA requirements without using any Canadian parts and materials in its production depends very much on the *level* of the applicable CVA requirements. For example, if the level of the CVA requirements is very high, we can see that the use of domestic goods may well be a necessity and thus be, in practice, required as a *condition* for eligibility for the import duty exemption. By contrast, if the level of the CVA requirements is very low, it would be much easier to satisfy those requirements *without* actually using domestic goods; for example, where the CVA requirements are set at 40 per cent, it might be possible to satisfy that level simply with the aggregate of other elements of Canadian value added, in particular, labour costs. The multiplicity of *possibilities* for compliance with the CVA requirements, when these requirements are set at low levels, may, depending on the specific level applicable to a particular manufacturer, make the use of domestic goods only one *possible* means (means which might not, in fact, be utilized) of satisfying the CVA requirements.

131. In our view, the Panel's examination of the CVA requirements for specific manufacturers was insufficient for a reasoned determination of whether contin-

[136] Panel Report, para. 10.216.
[137] *Supra*, para. 125.

gency "in law" on the use of domestic over imported goods exists. For the MVTO 1998 manufacturers and most SRO manufacturers, the Panel did not make findings as to what the actual CVA requirements are and how they operate for individual manufacturers. Without this vital information, we do not believe the Panel knew enough about the measure to determine whether the CVA requirements were contingent "in law" upon the use of domestic over imported goods. We recall that the Panel did make a finding as to the level of the CVA requirements for one company, CAMI. The Panel stated that the CVA requirements for CAMI are 60 per cent of the cost of sales of vehicles sold in Canada.[138] At this level, it may well be that the CVA requirements operate as a condition for using domestic over imported goods. However, the Panel did *not* examine how the CVA requirements would actually operate at a level of 60 per cent.

132. The Panel's failure to examine fully the legal instruments at issue here and their implications for individual manufacturers vitiates its conclusion that the CVA requirements do not make the import duty exemption contingent "in law" upon the use of domestic over imported goods. In the absence of an examination of the operation of the applicable CVA requirements for individual manufacturers, the Panel simply did not have a sufficient basis for its finding on the issue of "in law" contingency. Thus, we conclude that the Panel erred in conducting its "in law" contingency analysis.

133. In *Australia - Salmon*, we stated that where we have reversed a finding of a panel, we should attempt to complete a panel's legal analysis "to the extent possible on the basis of the factual findings of the Panel and/or of undisputed facts in the Panel record".[139] Here, as we have stated, the Panel did not identify the precise levels of the CVA requirements applicable to specific manufacturers. In addition, there are not sufficient undisputed facts in the Panel record that would enable us to examine this issue ourselves. As a result, it is impossible for us to assess whether the use of domestic over imported goods is a condition "in law" for satisfying the CVA requirements, and, therefore, is a condition for receiving the import duty exemption.

134. In light of these considerations, we are unable to complete the legal analysis necessary to determine whether the import duty exemption, through the application of the CVA requirements, is contingent "in law" upon the use of domestic over imported goods. Therefore, we make no finding and reserve our judgment on whether the import duty exemption at issue is contingent "in law" upon the use of domestic over imported goods within the meaning of Article 3.1(b) of the *SCM Agreement*.

B. Whether the Measure is Contingent "in Fact" Upon the Use of Domestic over Imported Goods

135. On appeal, the European Communities and Japan have maintained that if we find that the measure is not contingent "in law" upon the use of domestic over

[138] Panel Report, para. 10.205.
[139] *Supra*, footnote 114, para. 118.

imported goods, then they appeal, in the alternative, the Panel's finding that Article 3.1(b) of the *SCM Agreement* does not apply to subsidies contingent "in fact" upon the use of domestic over imported goods.[140] The European Communities and Japan contend that Article 3.1(b) applies to subsidies contingent "in fact" upon the use of domestic over imported goods[141], and argue that the import duty exemption is precisely such a prohibited subsidy.[142]

136. The Panel examined the issue of whether Article 3.1(b) extends to subsidies contingent "in fact" upon the use of domestic over imported goods, and found as follows:

> …we recall that Article 3.1 is, as clearly indicated by its chapeau, the provision that sets out the subsidies prohibited under the *SCM Agreement*. Paragraphs (a) and (b) are both part of Article 3.1 and manifestly similar. It is hard to imagine how the inclusion of the words "in law or in fact" in paragraph (a) and the absence of such words in paragraph (b) could be but a reflection of the intention of the drafters. We further recall that the Appellate Body has held in *Japan - Alcoholic Beverages* that "omission must have some meaning". That two provisions so alike and juxtaposed together should differ from each other in such specific respect signals, in our view, that the omission of the words "in law or in fact" from Article 3.1(b) was deliberate and that *Article 3.1(b) extends only to contingency in law*.[143] (emphasis added; footnote omitted)

137. In examining this issue, the Panel appears to have taken the view that the terms of Article 3.1(b), on their own, do not answer the question, and, therefore, it turned to the context provided by Article 3.1(a). In this respect, the Panel relied on the fact that, in Article 3.1(a), there is explicit language applying to subsidies contingent "in law or in fact" while in Article 3.1(b) there is not. In the view of the Panel, the absence of such an explicit reference in the adjacent and closely-related provision of Article 3.1(b) indicates that the drafters intended Article 3.1(b) to apply only to those subsidies which are contingent "in law" upon the use of domestic over imported goods.

138. In our view, the Panel's analysis was incomplete. As we have said, and as the Panel recalled, "omission must have some meaning."[144] Yet omissions in different contexts may have different meanings, and omission, in and of itself, is not necessarily dispositive. Moreover, while the Panel rightly looked to Article 3.1(a) as relevant context in interpreting Article 3.1(b), the Panel failed to examine

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[140] European Communities' appellant's submission, paras. 53-54; Japan's appellant's submission, para. 19.
[141] Ibid., paras. 55-61; Japan's appellant's submission, paras. 20-33.
[142] Ibid., para. 53; Japan's appellant's submission, paras. 36-51.
[143] Panel Report, para. 10.221.
[144] Appellate Body Report, *Japan - Taxes on Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, DSR 1996:Ibid., 97, at112.

other contextual elements for Article 3.1(b) and to consider the object and purpose of the *SCM Agreement*.

139. We look first to the text of Article 3.1(b). In doing so, we observe that the ordinary meaning of the phrase "contingent…upon the use of domestic over imported goods" is not conclusive as to whether Article 3.1(b) covers both subsidies contingent "in law" and subsidies contingent "in fact" upon the use of domestic over imported goods. Just as there is nothing in the language of Article 3.1(b) that specifically *includes* subsidies contingent "in fact", so, too, is there nothing in that language that specifically *excludes* subsidies contingent "in fact" from the scope of coverage of this provision. As the text of the provision is not conclusive on this point, we must turn to additional means of interpretation. Accordingly, we look for guidance to the relevant context of the provision.

140. Although we agree with the Panel that Article 3.1(a) is relevant context, we believe that other contextual aspects should also be examined. First, we note that Article III:4 of the GATT 1994 also addresses measures that favour the use of domestic over imported goods, albeit with different legal terms and with a different scope. Nevertheless, both Article III:4 of the GATT 1994 and Article 3.1(b) of the *SCM Agreement* apply to measures that require the use of domestic goods over imports. Article III:4 of the GATT 1994 covers both *de jure* and *de facto* inconsistency.[145] Thus, it would be most surprising if a similar provision in the *SCM Agreement* applied only to situations involving *de jure* inconsistency.

141. Second, we recall our findings in *European Communities - Regime for the Importation, Sale and Distribution of Bananas* ("*European Communities - Bananas*") on whether or not Article II of the GATS covers cases of *de facto* discrimination.[146] In that case, the Panel found that Article XVII of the GATS provides relevant context for determining whether Article II of the GATS applies to both *de jure* and *de facto* discrimination. On this issue, we said:

> Article XVII of the GATS is merely one of many provisions in the *WTO Agreement* that require the obligation of providing "treatment no less favourable". The possibility that the two Articles may not have exactly the same meaning does *not* imply that the intention of the drafters of the GATS was that a *de jure*, or formal, standard should apply in Article II of the GATS. If that were the intention, why does Article II not say as much? The obligation imposed by Article II is unqualified. The ordinary meaning of this provision does not exclude *de facto* discrimination.[147]

We believe the same reasoning is applicable here. The fact that Article 3.1(a) refers to "in law or in fact", while those words are absent from Article 3.1(b), does not necessarily mean that Article 3.1(b) extends only to *de jure* contingency.

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[145] See, e.g., panel report, *Italian Discrimination against Imported Agricultural Machinery*, L/833, BISD 7S/60, adopted 23 October 1958, para. 12.

[146] Appellate Body Report, WT/DS27/AB/R, adopted 25 September 1997, DSR 1997:II, 591, para. 233.

[147] Ibid., WT/DS27/AB/R, adopted 25 September 1997, DSR 1997:II, 591, para. 233.

142. Finally, we believe that a finding that Article 3.1(b) extends only to contingency "in law" upon the use of domestic over imported goods would be contrary to the object and purpose of the *SCM Agreement* because it would make circumvention of obligations by Members too easy. We expressed a similar concern with respect to the GATS in *European Communities - Bananas* when we said:

> Moreover, if Article II was not applicable to *de facto* discrimination, it would not be difficult - and, indeed, it would be a good deal easier in the case of trade in services, than in the case of trade in goods - to devise discriminatory measures aimed at circumventing the basic purpose of that Article.[148]

143. For all these reasons, we believe that the Panel erred in finding that Article 3.1(b) does not extend to subsidies contingent "in fact" upon the use of domestic over imported goods. We, therefore, reverse the Panel's broad conclusion that "Article 3.1(b) extends only to contingency in law."[149]

144. Having reached this conclusion, we must now consider whether the import duty exemption, as a result of the application of the CVA requirements, constitutes a subsidy contingent "in fact" upon the use of domestic over imported goods. We recall once more our statement in *Australia - Salmon* that, where we have reversed a finding of a panel, we should attempt to complete a panel's legal analysis "to the extent possible on the basis of the factual findings of the Panel and/or of undisputed facts in the Panel record".[150]

145. We stated earlier that the Panel's incomplete analysis of the operation of the CVA requirements leaves us with an insufficient basis on which to examine how the CVA requirements function. Furthermore, as the Panel concluded that Article 3.1(b) did not extend to contingency "in fact", the Panel did not examine the claims of the European Communities and Japan on this issue. As a result the Panel made *no* factual findings relating to the operation of the CVA requirements. In addition, there are not sufficient undisputed facts in the Panel record that would enable us to examine this issue ourselves. It is impossible for us to assess whether the use of domestic over imported goods is "in fact" a condition for satisfying the CVA requirements, and, therefore, is a condition for receiving the import duty exemption.

146. We are thus unable to complete the legal analysis necessary to determine whether the import duty exemption, through the application of the CVA requirements, is contingent "in fact" upon the use of domestic over imported goods. Accordingly, we make no finding and reserve our judgment on whether the import duty exemption at issue is contingent "in fact" upon the use of domestic over imported goods within the meaning of Article 3.1(b) of the *SCM Agreement*.

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[148] *Supra*, footnote 146, para. 233.
[149] Panel Report, para. 10.221.
[150] *Supra*, footnote 114, para. 118.

IX. ARTICLE I:1 AND ARTICLE II:1 OF THE GATS

147. Canada appeals the Panel's conclusion that the import duty exemption is inconsistent with Article II:1 of the GATS. Canada first appeals the Panel's finding that the measure is one "affecting trade in services" within the scope of Article I:1 of the GATS.[151] It then appeals the finding that Canada does not accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country contrary to its obligations under Article II:1 of the GATS.[152]

A. Article I:1 of the GATS

148. Canada maintains that the Panel erred in finding that the import duty exemption falls within the scope of the GATS. In the view of Canada, the Panel mistakenly concluded that whether a measure is within the scope of the GATS is determined by whether that measure is consistent with certain substantive obligations, such as Article II, and not by whether the measure falls within Article I of the GATS.[153]

149. The Panel first examined the general issue of whether the import duty exemption constitutes a measure "affecting trade in services" within the meaning of Article I of the GATS. The Panel then referred to the reports of the panel and the Appellate Body in *European Communities - Bananas* for the proposition that "the term 'affecting' in Article I of the GATS has a broad scope of application and that accordingly no measures are *a priori* excluded from the scope of application of the GATS."[154]

150. The Panel ultimately found that:

> [t]he determination of whether a measure affects trade in services cannot be done in abstract terms in isolation from examining whether the effect of such a measure is consistent with the Member's obligations and commitments under the GATS. In this case, the determination of whether the MVTO 1998 and SROs are measures affecting trade in services within the meaning of Article I of the GATS should be done on the basis of the determination of whether these measures constitute less favourable treatment for the services and service suppliers of some Members as compared to those of others (Article II) and/or for services and service suppliers of other Members as compared to domestic ones (Article XVII).[155]

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151 Canada's appellant's submission, para. 102.
152 Ibid., para. 145.
153 Ibid., para. 102.
154 Panel Report, para. 10.231.
155 Ibid., para. 10.234.

151. In *United States - Import Prohibition of Certain Shrimp and Shrimp Products*, we said, in the context of Article XX of the GATT 1994, that a panel may not ignore the "fundamental structure and logic" of a provision in deciding the proper sequence of steps in its analysis, save at the peril of reaching flawed results.[156] Similarly, here, the fundamental structure and logic of Article I:1, in relation to the rest of the GATS, require that determination of whether a measure is, in fact, covered by the GATS must be made *before* the consistency of that measure with any substantive obligation of the GATS can be assessed.

152. Article II:1 of the GATS states expressly that it applies only to "any measure covered by this Agreement". This explicit reference to the scope of the GATS confirms that the measure at issue must be found to be a measure "affecting trade in services" within the meaning of Article I:1, and thus covered by the GATS, *before* any further examination of consistency with Article II can logically be made. We find, therefore, that the Panel should have inquired, as a threshold question, into whether the measure is within the scope of the GATS by examining whether the import duty exemption is a measure "affecting trade in services" within the meaning of Article I. In failing to do so, the Panel erred in its interpretative approach.

153. We proceed to the threshold analysis of Article I of the GATS. Article I:1 of the GATS states, in pertinent part:

> Article I
>
> *Scope and Definition*
>
> 1. This Agreement applies to measures by Members *affecting trade in services.*
> 2. For the purposes of this Agreement, *trade in services* is defined as *the supply of a service*:
> (a) from the territory of one Member into the territory of any other Member;
> (b) in the territory of one Member to the service consumer of any other Member;
> (c) *by a service supplier of one Member, through commercial presence in the territory of any other Member*;
> (d) by a service supplier of one Member, through presence of natural persons of a Member in the territory of any other Member.
>
> (emphasis added)

[156] Appellate Body Report, WT/DS58/AB/R, adopted 6 November 1998, DSR 1998:VII, 2755, para. 119. See also Appellate Body Report, *United States - Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R, adopted 20 May 1996, DSR 1996:Ibid., 3, at 21.

154. Article XXVIII defines certain terms used in the GATS. We refer, in particular, to the following:

> (a) "measure" means any measure by a Member, whether in the form of a law, regulation, rule, procedure, decision, administrative action, or any other form;
>
> (b) "supply of a service" includes the production, distribution, marketing, sale and delivery of a service;
>
> (c) "measures by Members affecting trade in services" include measures in respect of
>
> …
>
> (iii) the presence, including commercial presence, of persons of a Member for the supply of a service in the territory of another Member;
>
> (d) "commercial presence" means any type of business or professional establishment, including through
>
> (i) the constitution, acquisition or maintenance of a juridical person,…
>
> …
>
> within the territory of a Member for the purpose of supplying a service;
>
> …
>
> (f) "service of another Member" means a service which is supplied,
>
> …
>
> (ii) in the case of the supply of a service through commercial presence or through the presence of natural persons, by a service supplier of that other Member;
>
> (g) "service supplier" means any person that supplies a service;
>
> …

155. With these treaty provisions in mind, we believe that at least two key legal issues must be examined to determine whether a measure is one "affecting trade in services": first, whether there is "trade in services" in the sense of Article I:2; and, second, whether the measure in issue "affects" such trade in services within the meaning of Article I:1.

156. We look first at whether there is "trade in services" in this case. For the purposes of the GATS, "trade in services" is defined in Article I:2 as the "supply of a service" in any one of four listed modes of supply. At issue here is the supply of a service under mode (c) of Article I:2, that is, the supply of a service "by a service supplier of one Member, through *commercial presence* in the territory of any other Member". (emphasis added) "Commercial presence" is, in turn, defined

in Article XXVIII(d) as "any type of business or professional establishment, including through (i) the constitution, acquisition or maintenance of a juridical person…".

157. The complainants in this case allege that the "trade in services" here relevant is "wholesale trade services of motor vehicles", which is a category of services recognized in the Central Product Classification.[157] Canada does not dispute that there are service suppliers of the United States, the European Communities and Japan which are established in Canada and which provide wholesale trade services of motor vehicles.[158] Accordingly, we hold that the "trade in services" here in issue is wholesale trade services of motor vehicles supplied by service suppliers of certain Members through commercial presence in Canada.

158. Having concluded that there is, in fact, "trade in services" in this case, we consider next whether the measure at issue "affects" trade in services. In *European Communities - Bananas*, we said:

> In our view, the use of the term "affecting" reflects the intent of the drafters to give a broad reach to the GATS. The ordinary meaning of the word "affecting" implies a measure that has "an effect on", which indicates a broad scope of application. This interpretation is further reinforced by the conclusions of previous panels that the term "affecting" in the context of Article III of the GATT is wider in scope than such terms as "regulating" or "governing".[159]

159. We also found in that case that, although the subject matter of the GATT 1994 and that of the GATS are different, particular measures "could be found to fall within the scope of both the GATT 1994 and the GATS", and that such measures include those "that involve a service relating to a particular good or a service supplied in conjunction with a particular good." [160] We further stated, in that case, that:

> Whether a certain measure affecting the supply of a service related to a particular good is scrutinized under the GATT 1994 or the GATS, or both, is a matter that can only be determined on a case-by-case basis.[161]

160. In cases where the same measure can be scrutinized under *both* the GATT 1994 and the GATS, however, the focus of the inquiry, and the specific aspects of the measure to be scrutinized, under each agreement, will be different because

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[157] Provisional Central Product Classification, United Nations Statistical Papers, Series M, No. 77, 1991, Subclass 61111, p. 189. This was replaced in 1997 by the Central Product Classification (CPC) Version 1.0 (United Nations Statistical Papers, Series M, No. 77, 1998, Subclass 61281, p. 363), which continues to recognize wholesale trade services of motor vehicles as a category of services.

[158] Panel Report, para. 10.237.

[159] *Supra*, footnote 146, para. 220.

[160] *Supra*, footnote 146, para. 221.

[161] *Supra*, footnote 146,; see also Appellate Body Report, *Canada - Certain Measures Concerning Periodicals*, WT/DS31/AB/R, adopted 30 July 1997, DSR 1997:Ibid., 449, at 465.

the subjects of the two agreements are different. Under the GATS, as we stated in *European Communities - Bananas*, "the focus is on how the measure affects the supply of the service or the service suppliers involved."[162]

161. We note that Canada argues that the import duty exemption is not a measure "affecting trade in services" within the meaning of Article I of the GATS, because it is a tariff measure that affects the *goods* themselves and not the supply of distribution services.[163] As such, Canada maintains, the measure at issue does not "affect" a service supplier in its *capacity as a service supplier* and in its *supply of a service*.[164] Canada relies on our report in *European Communities - Bananas* to support its argument that the import duty exemption falls exclusively within the scope of the GATT 1994, as it affects trade in goods as goods, and does *not* involve a service *relating to a particular good* or a service *supplied in conjunction with a particular good*.[165]

162. The Panel, however, determined that:

> Like the measures at issue in the *EC - Bananas III* case, the import duty exemption granted only to manufacturer beneficiaries bears upon conditions of competition in the supply of distribution services, regardless of whether it directly governs or indirectly affects the supply of such services. In our view, therefore, the import duty exemption falls in the third category of measures, identified by the Appellate Body in *EC - Bananas III*, as involving "a service relating to a particular good or a service supplied in conjunction with a particular good", which "could be scrutinized under both the GATT 1994 and the GATS".[166]

163. In *European Communities - Bananas*, we agreed with the panel that "the operators as defined under the relevant regulations of the European Communities are, indeed, suppliers of 'wholesale trade services' within the definition set out in the Headnote to Section 6 of the CPC."[167] Although the operators in that case were engaged in certain activities that were not, strictly speaking, within the definition of "distributive trade services" in the Headnote to Section 6 of the Central Product Classification, we concluded there that "there is no question that they are also engaged in other activities involving the wholesale distribution of bananas that are within that definition."[168] With respect to the fact that the operators were vertically integrated with producers, ripeners and retailers, we stated, in that case, that "even if a company is vertically-integrated, and even if it performs other functions related to the production, importation, distribution and processing of a product, *to the extent that it is also engaged in providing 'wholesale trade serv-*

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[162] *Supra*, footnote 146, para. 221.
[163] Canada's appellant's submission, para. 115.
[164] Ibid., para. 115.
[165] Ibid., para. 115.
[166] Panel Report, para. 10.239.
[167] *Supra*, footnote 146, para. 225.
[168] *Supra*, footnote 146, para. 225.

ices' and is therefore *affected in that capacity* by a particular measure of a Member *in its supply of those 'wholesale trade services'*, that company *is a service supplier* within the scope of the GATS."[169] (emphasis added)

164. In this case, the Panel did not examine any evidence relating to the provision of wholesale trade services of motor vehicles within the Canadian market and, as a result, did not make any factual findings as to the structure of the market for motor vehicles in Canada, nor as to which companies actually provide wholesale trade services of motor vehicles. As a result, the Panel also never examined whether or how the import duty exemption affects *wholesale trade service suppliers in their capacity as service suppliers*. Rather, the Panel simply stated:

> Like the measures at issue in the *EC - Bananas III* case, the import duty exemption granted only to *manufacturer beneficiaries* bears upon conditions of competition in the supply of distribution services, regardless of whether it directly governs or indirectly affects the supply of such services.[170] (emphasis added)

165. We do not consider this statement of the Panel to be a sufficient basis for a legal finding that the import duty exemption "affects" wholesale trade services of motor vehicles *as services*, or wholesale trade service suppliers *in their capacity as service suppliers*. The Panel failed to analyze the evidence on the record relating to the provision of wholesale trade services of motor vehicles in the Canadian market. It also failed to articulate what it understood Article I:1 to require by the use of the term "affecting". Having interpreted Article I:1, the Panel should then have examined all the relevant facts, including *who* supplies wholesale trade services of motor vehicles through commercial presence in Canada, and *how* such services are supplied. It is not enough to make assumptions. Finally, the Panel should have applied its interpretation of "affecting trade in services" to the facts it should have found.

166. The European Communities and Japan may well be correct in their assertions that the availability of the import duty exemption to certain manufacturer beneficiaries of the United States established in Canada, and the corresponding unavailability of this exemption to manufacturer beneficiaries of Europe and of Japan established in Canada, has an effect on the operations in Canada of wholesale trade service suppliers of motor vehicles and, therefore, "affects" those wholesale trade service suppliers in their capacity as service suppliers. However, the Panel did not examine this issue. The Panel merely asserted its conclusion, without explaining how or why it came to its conclusion. This is not good enough.

167. For these reasons, we believe that the Panel has failed to examine whether the measure is one "affecting trade in services" as required under Article I:1 of the GATS. The Panel did not show that the measure at issue affects wholesale trade services of motor vehicles, as services, or wholesale trade service suppliers

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[169] *Supra*, footnote 146, para. 227.
[170] Panel Report, para. 10.239.

of motor vehicles, in their *capacity as service suppliers*. Nonetheless, we continue our analysis of the issues raised on appeal under Article II:1, and examine whether, in the terms of that provision, the measure accords treatment "no less favourable" to like services and service suppliers of other Members.

B. Article II:1 of the GATS

168. Canada argues that even if the GATS was held applicable to the measure at issue, the Panel is still in error in finding that this measure accords less favourable treatment to services and service suppliers of any other Member under Article II:1.[171] Canada states that neither the European Communities nor Japan contended that the import duty exemption discriminates "in law"; rather, they argue that the import duty exemption discriminates "in fact" by according less favourable treatment in practice to certain services and service suppliers.[172] In Canada's view, the Panel "was required to set out the basis on which the measures accord less favourable treatment to certain services and service suppliers and to show how such less favourable treatment is accorded, either in fact or in law, to the services or service suppliers of certain Members."[173]

169. In examining Canada's appeal under Article II:1 of the GATS, we begin with the text of that provision:

> Article II
>
> *Most-Favoured-Nation Treatment*
>
> 1. With respect to any measure covered by this Agreement, each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country.

170. The wording of this provision suggests that analysis of the consistency of a measure with Article II:1 should proceed in several steps. First, as we have seen, a threshold determination must be made under Article I:1 that the measure is covered by the GATS.[174] This determination requires that there be "trade in services" in one of the four modes of supply, and that there be also a measure which "affects" this trade in services. We have already held that the Panel failed to undertake this analysis.[175]

171. If the threshold determination is that the measure *is* covered by the GATS, appraisal of the consistency of the measure with the requirements of Article II:1 is the next step. The text of Article II:1 requires, in essence, that treatment by one Member of "services and services suppliers" of any other Member be compared

[171] Canada's appellant's submission, para. 145.
[172] Ibid., para. 146.
[173] Ibid., para. 147.
[174] *Supra*, para. 152.
[175] *Supra*, para. 167.

with treatment of "like" services and service suppliers of "any other country". Based on these core legal elements, the Panel should first have rendered its interpretation of Article II:1. It should then have made factual findings as to treatment of wholesale trade services and service suppliers of motor vehicles of different Members commercially present in Canada. Finally, the Panel should have applied its interpretation of Article II:1 to the facts as it found them.

172. The Panel did none of this. The Panel did not inquire into how the market for wholesale trade services of motor vehicles in Canada is structured. Nor did it explain how less favourable treatment resulted from the measure at issue. Instead, it engaged in speculation about the "possibility" of certain relationships.[176] In response to Canada's argument that there is no competition between service suppliers at the wholesale level because of vertical integration and exclusive distribution arrangements in the motor vehicle industry, the Panel stated that vertical integration:

> …neither rules out potential competition in the wholesaler-manufacturer relationship, nor actual competition in the wholesaler-retailer relationship. Although due to the existing structure of the market, wholesale trade service suppliers procure their vehicles from the same manufacturers, no government measure prevents even a vertically integrated wholesale distributor from approaching different manufacturers for the procurement of motor vehicles.[177]

173. Based on this speculative analysis, the Panel proceeded to make the following "findings":

> We therefore **find** that vertical integration and exclusive distribution arrangements between manufacturers and wholesalers in the motor vehicle industry *do not rule out the possibility* that treatment less favourable *may be granted* to suppliers of wholesale trade services for motor vehicles. We also **find** that vertical integration and exclusive distribution arrangements *do not preclude potential competition* among wholesalers for the procurement of vehicles from manufacturers and actual inter-brand competition for sales to retailers.[178] (emphasis in italics added)

174. We consider these "findings" of the Panel to be pure speculation. As we stated above, the Panel did not provide an interpretation of Article II:1; nor did it apply its interpretation to findings of fact. The Panel did not identify any evidence defining the relationship between manufacturers and wholesale trade service suppliers of motor vehicles in the Canadian market. Furthermore, the Panel did not examine, *in concreto*, the structure of competition in the wholesale trade services market for motor vehicles in Canada. Its reasoning seems to be based

[176] Panel Report, paras. 10.253-10.254.
[177] Ibid., para. 10.253.
[178] Ibid., para. 10.254.

solely on Canada's argument that the motor vehicle industry is characterized by vertical integration of production and distribution as well as exclusive distribution arrangements.[179] The Panel failed to conduct an analysis of whether and how the import duty exemption affects wholesalers related to manufacturers which benefit from the import duty exemption, as compared with wholesalers related to manufacturers which do not benefit from the import duty exemption. For these reasons, we reverse the Panel's "findings" in paragraph 10.254 of the Panel Report.

175. The Panel also considered two additional arguments of the complainants. The European Communities and Japan argued before the Panel that, although the criteria for eligibility for the import duty exemption are not expressly based on nationality, the import duty exemption constitutes *de facto* discrimination under Article II of the GATS as all, or almost all, service suppliers of other Members which benefit from the exemption are of the United States.[180] Canada disputed this point and argued that at least two manufacturer beneficiaries are of European Communities' origin (Volvo Canada Ltd. and DaimlerChrysler Canada Inc.). Canada also maintained, before the Panel, that CAMI is a 50/50 joint venture between juridical persons of Japan and of the United States. The European Communities and Japan alleged, before the Panel, that the import duty exemption also results in *de jure* discrimination under Article II, because, in their view, the existence of the closed list of manufacturer beneficiaries constitutes formally different treatment.[181]

176. After finding that DaimlerChrysler Canada Inc. and Volvo Canada Ltd. are both juridical persons of the United States, and deciding that there is no evidence which would allow it to determine which juridical person "controls" CAMI, the Panel stated:

> Although none of the criteria for granting the import duty exemption is expressly based on nationality, the manufacturing presence requirement, referring to the period 1 August 1963 - 31 July 1964 in the MVTO 1998, has allowed only three service suppliers of the United States (Chrysler Canada Ltd., General Motors of Canada Ltd. and Ford Motor Company of Canada Ltd.) and one service supplier of Sweden (Volvo Canada Ltd.) to qualify for the import duty exemption. It was noted above that Volvo Canada Ltd. recently passed under the control of a juridical person of the United States (Ford Motor Co.). SROs have been used to expand the category of manufacturer beneficiaries by allowing two other manufacturers/wholesalers of automobiles (Intermeccanica of Canada and CAMI, a 50/50 joint venture between Suzuki Motor Co. of Japan and General Motors Corp. of the United States) and several manu-

[179] Panel Report, para. 10.253.
[180] Ibid., para. 10.255.
[181] Ibid., para. 10.255.

> facturers/wholesalers of buses and specified commercial vehicles to qualify for the import duty exemption.[182] (footnote omitted)

177. Having determined which manufacturer beneficiaries are "of " which Members, the Panel does not go on to explain the relevance of these findings to its analysis under Article II:1. In particular, the Panel does not clearly link these "manufacturer beneficiaries" to the suppliers of wholesale trade services of motor vehicles, which are the relevant entities under Article II:1.

178. The Panel concludes as follows:

> In our view, the import duty exemption, as provided in the MVTO 1998 and SROs, results in less favourable treatment accorded to services and service suppliers of any other Member within the meaning of Article II:1 of the GATS, as such benefit is granted to a limited and identifiable group of manufacturers/wholesalers of motor vehicles of some Members, selected on the basis of criteria such as the manufacturing presence in a given base year. We also note that the manufacturing presence requirements in the MVTO 1998 and in the SROs explicitly exclude suppliers of wholesale trade services of motor vehicles, which do not manufacture vehicles in Canada, from qualifying for the import duty exemption. In addition, the fact that in 1989 the Government of Canada stopped granting SROs makes the list of the beneficiaries of the import duty exemption a closed one. As a result, manufacturers/wholesalers of motor vehicles of some Members can import vehicles into Canada duty-free, while manufacturers/wholesalers of other Members are explicitly prevented from importing vehicles duty free into Canada.[183]

179. The Panel ultimately found, on the basis of this reasoning, that "with respect to the import duty exemption, granted to a limited number of manufacturers/wholesalers of motor vehicles, Canada has failed to accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than it accords to like services and service suppliers of any other country."[184] On this basis, the Panel found that the import duty exemption is inconsistent with the requirements of Article II:1 of the GATS.[185]

180. Here, the Panel has compounded its earlier error in finding that the import duty exemption which benefits certain *manufacturers* of motor vehicles "is granted to a limited and identifiable group" of *manufacturer/wholesalers* of motor vehicles. The Panel appears to be saying here that the import duty exemption

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[182] Panel Report, para. 10.261.
[183] Ibid., para. 10.262.
[184] Ibid., para. 10.264.
[185] Ibid., para. 10.264.

is granted to certain *wholesalers* of a limited number of Members, and not to *wholesalers* of other Members. Furthermore, the Panel states that, as a result of the closed list, *wholesalers* of motor vehicles of a limited number of Members can import vehicles into Canada duty-free, while *wholesalers* of other Members are explicitly prevented from importing vehicles duty-free into Canada.[186]

181. Clearly, here the Panel is confusing the *application* of the import duty exemption to *manufacturers* with its possible *effect* on *wholesalers*. In our view, the Panel has conducted a "goods" analysis of this measure, and has simply extrapolated its analysis of how the import duty exemption affects manufacturers to wholesale trade service suppliers of motor vehicles. The Panel surmised, without analyzing the effect of the measure on wholesalers *as service suppliers*, that the import duty exemption, granted to a limited number of manufacturers, *ipso facto* affects conditions of competition among wholesalers *in their capacity as service suppliers*. As we stated earlier in respect of whether the measure at issue "affects trade in services", the Panel failed to demonstrate how the import duty exemption granted to certain *manufacturers*, but not to other *manufacturers*, affects the supply of *wholesale trade services* and *the suppliers of wholesale trade services* of motor vehicles. In reaching its conclusions under Article II:1 of the GATS, the Panel has neither assessed the relevant facts - we see no analysis of any evidence relating to the supply of *wholesale trade services* of motor vehicles - nor has it interpreted Article II of the GATS and applied that interpretation to the facts it found.

182. For these reasons, we reverse the Panel's conclusion that the import duty exemption accorded pursuant to the MVTO 1998 and the SROs is inconsistent with the requirements of Article II:1 of the GATS[187], and its findings leading to that conclusion.

183. In coming to this conclusion, we do not suggest that the import duty exemption does *not* affect wholesale trade services of motor vehicles in Canada. Nor do we conclude that Canada accords no less favourable treatment to services and service suppliers of any Member than that which it accords to like services and service suppliers of another country consistently with Article II:1 of the GATS. We make no such conclusion. We mean only to say that the Panel, in this case, failed to substantiate its conclusion that the import duty exemption is inconsistent with Article II:1 of the GATS. As such, we have no choice but to reverse the findings and conclusions of the Panel relating to Article II:1 of the GATS.

184. In reaching this conclusion, we are mindful of the importance of the GATS as a new multilateral trade agreement covered by the *WTO Agreement*. This appeal is only the second case in which we have been asked to review a panel's findings on provisions of the GATS. Given the complexity of the subject-matter of trade in services, as well as the newness of the obligations under the GATS, we believe that claims made under the GATS deserve close attention

[186] Panel Report, para. 10.262.
[187] Ibid., para. 10.264.

and serious analysis. We leave interpretation of Article II of the GATS to another case and another day.

X. FINDINGS AND CONCLUSIONS

185. For the reasons set out in this Report, the Appellate Body:

(a) upholds the Panel's conclusion that Canada acts inconsistently with Article I:1 of the GATT 1994 by granting the advantage of duty-free treatment to motor vehicles originating in certain countries, pursuant to the MVTO 1998 and the SROs, which advantage is not accorded immediately and unconditionally to like products originating in the territories of all other WTO Members;

(b) upholds the Panel's conclusion that Canada acts inconsistently with its obligations under Article 3.1(a) of the *SCM Agreement* by granting a subsidy which is contingent in law upon export performance, as a result of the application of the ratio requirements as one of the conditions for determining eligibility for the import duty exemption on motor vehicles under the MVTO 1998 and the SROs;

(c) finds that the Panel's failure to address the European Communities' alternative claim that the measure, as a result of the application of the CVA requirements as one of the conditions for the import duty exemption, is a subsidy contingent upon export performance within the meaning of Article 3.1(a) of the *SCM Agreement*, was a proper exercise of judicial economy;

(d) is unable to come to a conclusion, and hence reserves judgment, on whether or not the import duty exemption is, as a result of the application of the CVA requirements, contingent "in law" upon the use of domestic over imported goods under Article 3.1(b) of the *SCM Agreement*; reverses the Panel's conclusion that Article 3.1(b) does not extend to contingency "in fact"; and is unable to come to a conclusion, and hence reserves judgment, on whether or not the measure is contingent "in fact" upon the use of domestic over imported goods under Article 3.1(b) of the *SCM Agreement*, as a result of insufficient factual findings and undisputed facts in the Panel record;

(e) finds that the Panel has failed to examine whether the measure is one "affecting trade in services" as required under Article I:1 of the GATS; reverses the Panel's conclusion that the import duty exemption accorded pursuant to the MVTO 1998 and the SROs is inconsistent with the requirements of Article II:1 of the GATS; and also reverses the Panel's findings leading to its conclusion on Article II:1.

186. The Appellate Body recommends that the DSB request that Canada bring its measure found in this Report, and in the Panel Report as modified by this Report, to be inconsistent with Canada's obligations under Articles I:1 and III:4 of the GATT 1994, Article XVII of the GATS and paragraph (a) of Article 3.1 of the *SCM Agreement* into conformity with its obligations in those agreements.